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signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 20 September 2017

To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of  
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Subject: COMMISSION STAFF WORKING DOCUMENT  
IMPACT ASSESSMENT Accompanying the document  
Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND  
OF THE COUNCIL amending Regulation (EU) No 1093/2010 establishing  
a European Supervisory Authority (European Banking Authority),  
Regulation (EU) No 1094/2010 establishing a European Supervisory  
Authority (European Insurance and Occupational Pensions Authority),  
Regulation (EU) No 1095/2010 establishing a European Supervisory  
Authority (European Securities and Markets Authority), Regulation (EU) No  
345/2013 on European venture capital funds, Regulation (EU) No  
346/2013 on European social entrepreneurship funds, Regulation (EU) No  
600/2014 on markets in financial instruments, Regulation (EU) 2015/760  
on European long-term investment funds, Regulation (EU) 2016/2011 on  
indices used as benchmarks in financial instruments and financial contracts  
or to measure the performance of investment funds, Regulation (EU)  
2017/1129 on the prospectus to be published when securities are offered  
to the public or admitted to trading on a regulated market

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Delegations will find attached document SWD(2017) 308 final.

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Brussels, 20.9.2017  
SWD(2017) 308 final

## COMMISSION STAFF WORKING DOCUMENT

### IMPACT ASSESSMENT

#### *Accompanying the document*

#### **Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 345/2013 on European venture capital funds, Regulation (EU) No 346/2013 on European social entrepreneurship funds, Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2015/760 on European long-term investment funds, Regulation (EU) 2016/2011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market**

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## List of abbreviations

<b>AIF</b>	Alternative Investment Fund
<b>AIFMD</b>	Alternative Investment Fund Manager
<b>APAs</b>	Approved Publication Arrangements
<b>ARMs</b>	Approved Reporting Mechanisms
<b>BRRD</b>	Bank Recovery and Resolution Directive
<b>CA</b>	Competent Authority
<b>CCP</b>	Central Counterparty
<b>CEAOB</b>	Committee of European Auditing Oversight Bodies
<b>CEBS</b>	Committee of European Banking Supervisors
<b>CEIOPS</b>	Committee of European Insurance and Occupational Pensions Supervisors
<b>CESR</b>	Committee of European Securities Regulators
<b>CMU</b>	Capital Markets Union
<b>CMU SWD</b>	Capital Markets Union Staff Working Document
<b>CRAs</b>	Credit Rating Agencies
<b>CRD IV</b>	Capital Requirements Directive
<b>CRR</b>	Capital Requirements Regulation
<b>CSD</b>	Directive on Central Securities Depositories
<b>CSDR</b>	Regulation on Central Securities Depositories
<b>CTPs</b>	Consolidated Tape Providers
<b>DA</b>	Delegated Acts
<b>DGSD</b>	Deposit Guarantee Schemes Directive
<b>DRSPs</b>	Data Reporting Service Providers
<b>EBA</b>	European Banking Authority
<b>ECA</b>	European Court of Auditors
<b>ECB</b>	European Central Bank
<b>ECOFIN</b>	Economic and Financial Affairs Council

<b>ECON</b>	Committee on Economic and Monetary Affairs
<b>EFRAG</b>	European Financial Reporting Advisory Group
<b>EIOPA</b>	European Insurance and Occupational Pensions Authority
<b>ELTIF</b>	European Long-Term Investment Funds
<b>EMD</b>	Electronic Money Directive
<b>EMU</b>	Economic and Monetary Union
<b>EMIR</b>	European Market Infrastructure Regulation
<b>ESAs</b>	European Supervisory Authorities
<b>ESFS</b>	European System of Financial Supervision
<b>ESMA</b>	European Securities and Markets Authority
<b>ESRB</b>	European Systemic Risk Board
<b>ESRC</b>	European Systemic Risk Council
<b>EuSEF</b>	European Social Entrepreneurship Funds
<b>EuVECA</b>	European Venture Capital Funds
<b>FFR</b>	Framework Financial Regulation
<b>FICOD</b>	Financial Conglomerates Directive
<b>FTE</b>	Full Time Equivalent
<b>IFR</b>	Interchange Fee Regulation
<b>IORPs</b>	Institutions for Occupational Retirement Provision
<b>ITS</b>	Implementing Technical Standards
<b>MCD</b>	Mortgage Credit Directive
<b>MFF</b>	Multiannual Financial Framework
<b>MiFID</b>	Directive on Markets in Financial Instruments
<b>NACE</b>	Statistical classification of economic activities in the European Community
<b>OLAF</b>	European Anti-Fraud Office
<b>Omnibus II</b>	New European Supervisory Framework for Insurers
<b>OTC</b>	Over the counter

<b>PAD</b>	Payment Accounts Directive
<b>PRIIPs</b>	Regulation on Packaged Retail and Insurance-Based Investment Products
<b>PSD2</b>	Revised Directive on Payment Services
<b>QMV</b>	Qualified Majority Voting
<b>RSB</b>	Regulatory Scrutiny Board
<b>RTS</b>	Regulatory Technical Standards
<b>SMEs</b>	Small and Medium-Sized Enterprises
<b>SRB</b>	Single Resolution Board
<b>SSM</b>	Single Supervisory Mechanism
<b>TFEU</b>	Treaty on the Functioning of the European Union
<b>TRs</b>	Trade Repositories
<b>UCITS</b>	Undertakings for Collective Investment in Transferable Securities



## **Glossary**

<b>APAs</b>	An APA is a system that requires firms executing transactions to publish trade reports through a body that ensures timely and secure consolidation and publication of such data.
<b>ARMs</b>	An ARM is a platform that reports transactions on behalf of firms. This can also be done via the multilateral trading facility or regulated market on which the transaction was performed.
<b>Benchmarks</b>	Any index by reference to which the amount payable under a financial instrument or a financial contract, or the value of a financial instrument is determined or is used to measure the performance of an investment fund.
<b>CCP</b>	A legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer.
<b>CTPs</b>	A consolidated tape provider is a person authorised under MiFID II to provide the service of collecting trade reports for financial instruments from exchanges and consolidating them into a consolidated tape. A consolidated tape is an electronic system which combines sales volume and price data from different exchanges and certain broker-dealers. It consolidates these into a continuous electronic live data stream, providing summarised price and volume data by security across all markets.
<b>DRSPs</b>	DRSPs is a term used to refer to APAs, ARMs and CTPs collectively.
<b>OTC</b>	The phrase OTC can be used to refer to stocks that trade via a dealer network as opposed to on a regulated market. It also refers to debt securities and other financial instruments such as derivatives, which are traded through a dealer network.
<b>Prospectuses</b>	Prospectuses are public disclosure documents prepared by companies in the context of an offer of securities to the public and/or an admission of such securities to trading on a regulated market. Prospectuses contain all relevant information concerning the company and the securities to be offered to the public or admitted to trading. They are approved by a competent authority and their content is harmonised at EU level.
<b>TRs</b>	TRs are entities that centrally collect and maintain the records of derivatives.

## 1 Introduction and policy context

In response to the financial crisis of 2007/8, the EU reinforced its regulatory framework in line with global commitments. Furthermore, efforts to reduce differences in the implementation of the regulatory framework across Member States were stepped up via the development of a Single Rulebook for financial regulation in the EU. The European Supervisory Authorities ("ESAs") were established to ensure consistent application of the Single Rulebook and thereby promote both regulatory and supervisory convergence.<sup>1</sup> In this way, the ESAs have contributed to a smoother functioning Single Market for financial services as well as helping to deepen the Economic and Monetary Union ("EMU").

Despite the post-crisis measures, there remains significant potential to enhance regulatory and supervisory convergence in the Single Market. Integrated financial markets require more integrated supervisory arrangements to function effectively, while more centralised supervisory arrangements can, in turn, foster market integration. The ESAs can play a key role in this symbiotic relationship between market integration and supervisory convergence and can assume more direct responsibility for supervision in targeted areas. In assuming such enhanced responsibility for supervision, the ESAs must be adequately equipped in terms of powers, governance and funding.

The case in favour of targeted reinforcement of EU supervision is predicated on the need to address two main challenges:

- First, following the establishment of the Banking Union ("BU"), the EU has committed to further integration across the broader financial sector on a sound and stable basis. In particular, the Capital Markets Union ("CMU") has been launched so as to lay the foundations for a Single Market in capital. In this context, the Five Presidents' Report of June 2015<sup>2</sup> highlighted the need to strengthen the EU supervisory framework, leading ultimately to a single capital-markets supervisor. More recently, the Commission Reflection Paper on the deepening of EMU<sup>3</sup> suggests that a review of the ESAs should deliver the first steps towards such a single supervisor by 2019.
- Second, the financial crisis of 2007/8 revealed the risks linked to the interconnectedness of global financial markets and resulted in major international efforts to improve the consistency of regulation and supervision, notably among G20 countries. It is essential that EU supervisory arrangements develop in a manner which ensures that cross-border risks between the EU and the rest of the world can be

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<sup>1</sup> The three ESAs are: the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

<sup>2</sup> [https://ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union\\_en](https://ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en)

<sup>3</sup> The Five Presidents' Report: Completing Europe's Economic and Monetary Union June 22, 2015; Reflection Paper on the Deepening of the Economic and Monetary Union, COM(2017) 291 of 31 May 2017.

monitored and managed most effectively. The ESAs have a key role to play in this regard.

The decision of the United Kingdom to leave the EU reinforces these challenges for supervisory arrangements within the remaining EU27. The future departure of the EU's largest financial centre means that EU27 supervisory arrangements must be strengthened to ensure that financial markets continue to support the economy on an adequate and sound basis. In addition, the EU27 supervisory arrangements must take account of the fact that financial services providers based in the United Kingdom will relocate activities to the EU27, which will require enhanced monitoring and management from a financial-stability perspective. The ESAs again have a key role to play in addressing this specific challenge.

The upcoming ESAs review – which will cover powers, governance and funding - provides a very timely opportunity to consider the necessary targeted reinforcement of EU supervisory arrangements. Article 81 of the ESA Regulations provides for a review of the ESAs' operations in 2017, and the Commission's 2017 Work Programme announced a review of the European System of Financial Supervisors ("ESFS") (which comprises the three ESAs and the European Systemic Risk Board).

In preparing the review, the Commission services have carried out an evaluation of the operations of the ESAs which highlighted several important shortcomings. These include: (a) insufficiently defined powers to ensure effective supervision to the same standards across the EU; (b) the absence of powers to effectively deal with cross-border risks relating to interconnectedness between the EU and the rest of the world; (c) a governance framework that leads to a misalignment of incentives between the EU and national levels within decision-making processes; and (d) a funding framework that is not ensuring sufficiency in relation to the tasks allocated to the ESAs. (*See Annex 11.5*) These shortcomings limit the capacity of ESAs to deliver on their mandates in terms of financial stability and market functioning. A stakeholder consultation on the functioning of the ESAs, undertaken in the spring of 2017, highlighted similar shortcomings (*see Annex 11.2*).

The scope of this impact assessment covers the powers, governance and funding framework of the ESAs, as these are the areas which need to be reinforced to allow the ESAs to meet the challenges outlined above and to undertake the responsibility for direct supervision in targeted areas.

The impact assessment accompanies the Commission proposals to amend the following legal acts: Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority); Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority); Regulation (EU) No 2015/760 on European long-term investment funds; Regulation (EU) No 345/2013 on European venture capital funds; Regulation (EU) No 346/2013 on European social entrepreneurship funds; Regulation (EU) No 600/2014 on markets in financial instruments; Regulation (EU) 2016/2011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds; Regulation (EU) 2017/1129 on the prospectus to be published when

securities are offered to the public or admitted to trading on a regulated market, Directive 2014/65/EU on markets in financial instruments and the Commission's proposal for a Regulation amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012.. Neither the proposals nor the impact assessment cover macro-prudential aspects.

## 2 Evaluation and stakeholder consultation

In accordance with Article 81 of the ESA Regulations<sup>4</sup> an evaluation was carried out in combination with this impact assessment during the spring of 2017 (see Annex 11.5). This evaluation concludes that the ESAs have broadly delivered on their current objectives and that the current sectoral supervisory architecture of the ESAs is appropriate. However, targeted improvements are needed to face future challenges. In particular the evaluation concludes that:

- powers could be enhanced in some areas so as to ensure better regulatory and supervisory outcomes for all market participants and to ensure effective and efficient handling of cross border risk;
- the current governance framework seems conducive to conflicts of interests between the EU and national levels, which complicates the decision-making process and creates an apparent bias against using certain tools and powers;
- the current funding arrangements do not seem sustainable and commensurate with the tasks which the ESAs perform and will be expected to perform in the future. This inadequacy of funding risks becoming acute going forward, as the tasks to be carried out by the ESAs expand significantly. The current funding arrangements also reflect unjustified differences in contributions among Member States.

As a complement to the evaluation, the Commission service conducted an extensive public consultation in the spring of 2017. The consultation attracted almost 230 responses. Feedback was also gathered through targeted consultations with the ESAs and in exchanges with Member States and industry representatives. A summary of stakeholders' views is in Annex 11.2.

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<sup>4</sup> Article 81 of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010 – the ESA Regulations.

### 3 Background to the ESAs

#### 3.1 Brief history of the ESAs

The financial crisis of 2007/8 brought weaknesses in the EU financial supervisory arrangements sharply into focus. These supervisory arrangements were primarily national based arrangements, implying a patchwork of regulatory and supervisory requirements and insufficient cooperation and information exchange among national supervisors. In response, the Commission established a High Level Group on financial supervision in the EU, which came forward with recommendations based on the creation of a two pillar supervisory system as follows:<sup>5</sup>

- a *European System of Financial Supervisors ("ESFS")*, for the supervision of individual financial institutions ("micro-prudential supervision") consisting of new European Supervisory Authorities working in tandem with the national financial supervisors, and
- a *European Systemic Risk Council ("ESRC")* to oversee the stability of the financial system as a whole ("macro-prudential supervision") and provide early warning of systemic risks and recommendations where necessary (today's European Systemic Risk Board).

Building on those recommendations, the Commission put forward legislative proposals to strengthen EU level financial supervision in October 2009, which were adopted by the co-legislators in November 2010. The three ESAs – the European Banking Authority ("EBA"), the European Insurance and Occupational Pensions Authority ("EIOPA") and the European Securities and Markets Authority (ESMA) – became operational in January 2011. These new authorities were a reinforcement of the existing EU “committees of supervisors” – the Committee of European Banking Supervisors ("CEBS"), the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") and the Committee of European Securities Regulators ("CESR"), which had more limited powers and operated on a consensus-basis only.

#### 3.2 What the ESAs do

The **over-arching objective** of the ESAs is to sustainably reinforce the stability and effectiveness of the EU financial system and enhance consumer and investor protection. More specifically they should contribute to:

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<sup>5</sup> "Report of the high-level group on financial supervision in the EU", chaired by J. de Larosière, Brussels 25/2/2009. Available at: [http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf). The report has also been endorsed by the Spring European Council as a basis for action to reform financial supervision. See annex for a summary of the deviations from the de Larosière report in the options retained in this Impact Assessment.

- a) improving the functioning of the internal market, including, in particular, a sound, effective and consistent level of regulation and supervision;
- b) ensuring the integrity, transparency, efficiency and orderly functioning of financial markets;
- c) strengthening international supervisory coordination;
- d) preventing regulatory arbitrage and promoting equal conditions of competition;
- e) ensuring that risks in their respective sectors are appropriately regulated and supervised; and
- f) enhancing customer protection.

***The ESAs contribute to the Single Rulebook - regulatory activities***

The ESAs may, in areas specified in the relevant sectoral legislation (primary level, "level 1"), develop draft technical standards (secondary level, "level 2") that are endorsed by the Commission (i.e., Articles 10 to 15).<sup>6</sup>

The ESAs may also issue guidelines and recommendations with a view to establishing consistent, efficient and effective supervisory practices within the ESFS and to ensuring the common, uniform and consistent application of Union law (Article 16 of the ESA Regulations). The ESAs may also provide opinions to the European Parliament ("Parliament"), the Council and the Commission on all issues related to their area of competence such as, for instance, technical advice. (Article 34 ESA Regulations). The common framework developed by the EBA on the basis of EU legislation creates the conditions for all institutions operating in the EU single market to efficiently and safely fulfil their role of financial intermediaries.

***The ESAs contribute to and promote a common supervisory culture/convergence of supervisory practices***

The ESAs have a key role in promoting and monitoring the efficient, effective and consistent functioning of the colleges of supervisors. For this purpose they can participate in the

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<sup>6</sup> With regards to EBA and ESMA this includes, among others, the capital requirements framework (consisting of the capital requirements directive ("CRD IV") and the capital requirements regulation ("CRR")), the bank recovery and resolution directive ("BRRD"), the deposit guarantee schemes directive ("DGSD"), the revised directive on payment services ("PSD2"), the mortgage credit directive ("MCD"), the payment accounts directive ("PAD"), the regulation on key information documents for packaged retail and insurance-based investment products ("PRIIPs"), the fourth anti-money laundering directive ("AMLD"), the electronic money directive ("EMD"), the EU market infrastructure regulation ("EMIR"), the financial conglomerates directive ("FICOD"), the directive on central securities depositories ("CSD"), the markets in financial instruments directive ("MiFID II") and the interchange fee regulation ("IFR"). EIOPA, on the other hand, inherited responsibility for two sectors, insurance and occupational pension funds, where national markets, products and legislation vary markedly from one Member State to another. The creation of new draft regulations and technical input to the legal framework discussions have therefore been complex, in both the areas of insurance and occupational pension funds, with a considerable amount of work which is not reflected by draft regulatory measures (draft RTSs, draft ITSs, guidelines and recommendations).

activities of the supervisory colleges (Article 21(1) of the ESA Regulations). The ESA Regulations also empower the ESAs to carry out various activities in view of building a common EU supervisory culture and consistent supervisory practices, as well as to ensuring uniform procedures and consistent approaches throughout the Union (Article 29 of the ESA Regulations).

In order to strengthen consistency in supervisory outcomes the ESAs shall periodically organise and conduct peer reviews (Article 30(1) of the ESA Regulations). To carry out these duties the ESAs may request competent authorities ("CA") to provide them with all the necessary information including at recurring intervals and in specified formats (Article 35 of the ESA Regulations).

#### ***The ESAs ensure the consistent application of legally binding Union acts***

The ESA Regulations enable the ESAs to assist CAs at the request of one or more CAs in reaching a common approach or settling the matter. The ESAs also have direct decision making powers to require financial institution to comply with the obligations under Union law (Article 19 of the ESA Regulations).

Similarly the ESAs are entitled to address recommendations to CAs when a CA appears to be in breach of Union law and, following a predefined procedure and as a last resort, to directly address decisions to financial institutions to ensure respect of Union law which is directly applicable to them (Article 17 of the ESA Regulations).

#### ***The ESAs can take emergency actions***

The ESA Regulations set out that the ESAs must fulfil an active coordination role between CAs, in particular, in case of adverse developments which potentially jeopardise the orderly functioning and integrity of financial markets or the stability of the EU financial system. Following the determination of an emergency situation by the Council the ESAs may, as a last resort, adopt individual decisions directly to financial institutions/insurers requiring the necessary action including the cessation of any practice (Article 18 of the ESA Regulations).

#### ***The ESAs have a coordination function***

Beyond their coordination role in emergency situations the ESAs are required to promote a coordinated Union response particularly in adverse market conditions by e.g., facilitating information exchange between authorities, determining the scope/reliability of information to be made available by CAs and centralising information received, carrying out non-binding mediation, notifying to the ESRB potential emergency situations; taking all appropriate action to facilitate action by CAs (Article 31 of the ESA Regulations).

#### ***The ESAs have tasks related to consumer protection and financial activities***

The ESA Regulations require the ESAs to take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services. The ESAs may also issue warnings in the event that a financial activity poses a serious threat to the



ESAs' objectives and may, under specific circumstances, even "temporarily prohibit or restrict certain financial activities" which threaten the integrity of financial markets or the stability of the financial system (Article 9 ESA Regulations).

A more comprehensive outline of the background to the ESAs and what they do is developed in the evaluation report. *See* Annex 11.5.

### ***Decision-making of the ESAs***

The main decision-making body of the ESAs is the Board of Supervisors where representatives from national competent authorities from each Member State are the only representatives with voting powers. Decisions by the Board of Supervisors are generally taken by simple majority. However, qualified majority voting ("QMV") is used in the case of "regulatory decisions" under the ESA Regulations<sup>7</sup>.

The voting system within the EBA was modified after the creation of the Single Supervisory Mechanism ("SSM") to better take into account the position of Member States which do not participate in the Banking Union ("BU"). For instance, some EBA decisions require, in addition to the general majority requirements, a simple majority of national CAs participating in the SSM and a simple majority of national CAs not participating in the SSM, respectively ("double simple majority"). Other decisions require a simple majority from both participating and non-participating Member States and for those the EBA Regulation also foresees a mechanism to ensure that this system remains workable when the number of non-participating Member States decreases until the date when four or fewer voting members are from CAs of non-participating Member States. Decisions will then be adopted by a simple majority of the voting members of the Board of Supervisors, which shall include at least one vote from members from CAs of non-participating Member States. Chapter 7 on governance analyses in more detail the decision-making process within the ESAs.

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<sup>7</sup> Articles 10 to 16 of the ESA Regulations.

#### **4 General problem definition and General Baseline**

The overall objective of the ESAs is to sustainably reinforce the stability and effectiveness of the financial system throughout the EU and to enhance consumer and investor protection. After six years of operation, the evaluation and the public consultations undertaken by the European Commission services indicate that the ESAs are increasingly constrained in their capacity to meet this objective in the context of further integration of markets both within the EU and between the EU and the rest of the world. The constraints on the ESAs' functioning can be summarised in the form of two general problems:

1. General problem I is the constraints on the ESAs to fully fulfil their existing mandates. The ESAs are already stretched in their ability to meet existing tasks in full, i.e., in terms of delivering the right regulatory outputs<sup>8</sup> and supervisory convergence actions,<sup>9</sup> and will be under even greater pressure as the process of financial integration continues.
2. General problem II is the inadequate scope of existing mandates going forward. This problem concerns the absence or limited scope of certain powers and tasks over large EU-wide cross-border firms, products or market infrastructures, as well as over third-country instruments and aspects.

The constraints implied by these two general problems, described in more detail in the following sections, will become increasingly acute as the integration of EU financial markets deepens in future years, notably with the creation of the CMU and the growing interconnection between global financial markets, as well as a result of the United Kingdom's departure from the EU. The extent to which these problems have an impact on the three ESAs can largely vary. General problem I affects the ESA functioning in the same way across the three agencies. General problem II, instead, emerges more forcefully as an issue for ESMA and only in selected areas for the other two agencies.

The 2017 ESA review provides an opportunity to address the underlying problems at the earliest opportunity.

##### **4.1 General problem I**

As illustrated in the evaluation, the ESAs are facing increasing responsibilities and an increasing workload which have an important impact on their ability to meet their mandates in full especially from a forward looking perspective. Section 8.2.1.2 reviews evidence from different sources of this growing problem and illustrates the significant increase in Level 2 legislation compared to the situation when the ESAs were established in 2011. This scale of

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<sup>8</sup> This refers to the fact that while Level 2 legislation is enacted by the Commission, Level 1 legislation requires the ESAs to deliver the draft acts by specific dates to the Commission and these dates have often not been kept.

<sup>9</sup> Such as comply-or-explain guidelines or other interpretative guidance, peer reviews of supervisory practices, breach of Union law procedures or mediation between national CAs.

workload was not foreseen in 2010, when the ESAs were established. Meanwhile, feedback from stakeholders is critical of the ESAs for the failure to fully use their powers in some respects, e.g., fulfilling the mandate for regulatory convergence and supervisory convergence (*see* Annex 11.2).

Constraints on the ESAs to fully fulfil their mandates come from various sources:

1. The ESAs are constrained in fulfilling their objectives by insufficient and unclearly defined powers, e.g., when ensuring consistent application of EU law, drafting technical advice or providing ongoing support to equivalence decisions.
2. The constraints preventing the ESAs from fully fulfilling existing mandates is also attributable to the governance of the ESAs. Notably, the incentive structure in the decision-making process leads to a lack of decisions in particular in the area of regulatory convergence and supervisory convergence, or decisions that are overly oriented towards national instead of broader EU interests. This reflects an inherent tension between the European mandate of the ESAs and the national mandate of the competent authorities that are members of the ESA Boards.<sup>10</sup> For instance, due to the need for approval by the Board of Supervisors, the ESAs have made limited use of peer reviews, of their powers to settle disputes and pursue breaches of Union law. A greater role for the ESAs in deepening financial integration or strengthening the stability of the Single Market will also require effective convergence powers.<sup>11</sup>
3. Insufficient funding reduces the ESAs' ability to allocate resources in relation to their needs to fully meet their mandates. Current budget arrangements are and will be constraining the ESAs' activities, as pressure to consolidate public spending remains. Uneven contributions from Member States could also hamper the ESAs in managing their evolving funding needs, to the extent that Member States currently making a disproportionately large contribution (relative to the size of their financial sector) would be unwilling to increase their contributions further.

## 4.2 General problem II

The current scope of the ESAs' mandates must be reconsidered in the context of efforts to further integrate financial markets within the EU. In order to deepen market integration,<sup>12</sup>

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<sup>10</sup> See section 7.2 and the 2013 Study of the European Parliament "the Review of the New European System of Financial Supervision , Part 1: the Work of the European Supervisory Authorities (EBA, EIOPA and ESMA) ([http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507446/IPOL-ECON\\_ET\(2013\)507446\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507446/IPOL-ECON_ET(2013)507446_EN.pdf))

<sup>11</sup> "A more integrated supervisory framework ensuring common implementation of the rules for the financial sector and more centralised supervisory enforcement is key." Reflection Paper on the Deepening of the Economic and Monetary Union, page 20, COM(2017) 291 of 31 May 2017

<sup>12</sup> *See* the European Commission (2017), Staff Working Document, Economic Analysis accompanying the Communication on Capital Markets Union Mid-term Review, Chapter 1, p. 11; European Commission (2017), European Financial Integration and Stability Review, May, p. 18; European Central Bank (2017), Financial Integration in Europe, p. 3 (FINTEC indicators). While price-based indicators have not yet reached pre-crisis levels, they are at much higher level than 2011 and an EU indicator of home bias, which measures the extent to which domestic equity/bonds (held by EU residents in their country) are

and ensure more consistent supervisory practices and implementation of EU rules a more integrated supervision should be achieved in targeted areas. For example, a more integrated supervisory framework ensuring common implementation of the rules for the financial sector and more centralised supervisory enforcement has been identified as key to the completion of the CMU. The feasibility of more common supervision has already been showed in the case of trade repositories and credit rating agencies, directly supervised by ESMA. While there is no majority of stakeholders suggesting changes to the current toolkit available to the ESAs, recognition of the problem in some areas and support for targeted increases in centralised supervision is also part of the stakeholders' feedback to the ESAs review, particularly with respect to cross-border activities. Also the evaluation illustrates areas where the current toolkit is not sufficient. In light of the policy objectives of the CMU, more common direct supervision in targeted areas will mainly affect ESMA over the other two ESAs. For instance, the recent Commission proposal to amend the European Market Infrastructure Regulation ("EMIR")<sup>13</sup> strengthens ESMA's role in the supervision of Central Counterparty Clearing ("CCPs") to support the development of deeper and better integrated capital markets.

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overweighing their domestic investment portfolio (i.e. holding a proportion of domestic assets that is higher than the relative importance of local equity and bond markets over the total in the EU), is close to a historical bottom since early 2000s and anyway lower than its 2011 level (p. 11 CMU SWD). It is also worth to note that pre-crisis levels of financial integration were largely driven by financial flows concentrated in specific areas, like the interbank market. The financial reintegration process that is taking place after the crisis (mostly since 2011) relies on a more diversified set of financial flows (see CMU SWD, p. 10), which strengthens the stability of the financial system. Nonetheless, this diversification involves complexity and may require a more elaborated regulatory and supervisory framework to deal with potential sources of vulnerabilities that may not mainly come from the banking sector anymore.

<sup>13</sup> Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, COM(2017) 331 final, 2017/0136 (COD)

Figure 4.1 General Problem Tree



The general problems outlined above can be traced to issues relating to the powers, governance and funding of the ESAs. The following sections will discuss in detail the policy actions proposed in respect of these three drivers so as to ensure a proper assessment in terms of efficiency, coherence and effectiveness.

### **4.3 General baseline**

The ESAs' framework currently relies on a combination of powers, governance rules and funding structure that are aimed at ensuring a certain balance between national, EU and shared competences in matters related to banking, capital markets, pensions and insurance. Current ESAs' powers aim at ensuring a proper and convergent application of EU law and contributing to the Single Rulebook by preparing draft Level 2 legislation for adoption by the Commission. Over time, ESMA has also received specific powers to be the only supervisor that authorises and supervises credit rating agencies ("CRAs") and trade repositories ("TRs").

In general terms, the ESAs function according to a similar set of rules that determine their governance, powers and funding. For governance, rules relating to the appointment and powers of the Chairpersons and the Management Boards, the powers of the Boards of Supervisors as decision-making body, the allocation of voting powers among national competent authorities and the decision-making powers on operational matters are the same with the notable exception of EBA in relation to certain decisions (see Sections 3.2 and 7). All three ESAs are funded through public budgets distributed in fixed proportions between

the EU and national competent authorities' budgets. In addition, ESMA collects fees directly from market participants in the areas where it is directly supervising entities (CRAs and TRs). The current toolkit of powers for the three ESAs is also very similar and includes a key role in contributing to the Single Rulebook via selected tools to promote greater regulatory and supervisory convergence. In addition, ESMA currently has direct supervisory powers in relation to TRs and CRAs.

Without action, the baseline scenario would evolve towards an unsustainable situation for the ESAs and a worsening of the two general problems described in Section 4, i.e., the constraints to meet mandates in full and the inadequacy of the current scope of mandates. For instance, the ESAs would increasingly fall short in meeting their expected funding needs and so would be forced to reallocate resources and reprioritise actions while keeping the same mandates. Carrying on with the current ESA framework may also result in slow progress in supervisory convergence across the Single Market, as markets become more integrated and a growing number of entities and activities are conducted on a cross-border basis both within the EU and between the EU and the rest of the world, so increasing risks of major supervisory gaps. For instance, the current incentive structure in the decision making process may not ensure the needed regulatory and supervisory convergence stemming from more integrated markets, as well as an adequate response to issues in the implementation and enforcement of EU law. Moreover, the lack of direct supervisory powers in specific areas (such as data providers and EU-labelled funds) may increasingly create conflicts between national supervisory practices and cross-border activities in those markets, failing to reach the underlying objectives of the Single Rulebook. The current ESAs' framework would thus be unable to deal with more integrated financial markets on a sound and stable basis and to ensure coherence with key European financial policies, like the CMU and the BU.

## **5 The EU's right to act and justification**

The legal basis for the establishment of the ESAs is Article 114 of the Treaty on the Functioning of the European Union ("TFEU"). The objectives of the ESAs are set out in the ESA Regulations. It is to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses. The impact assessment accompanying the Commission's proposal on setting up the ESAs has demonstrated that these objectives are better achieved at Union level.

Article 81 of the ESA Regulations provides for an obligation for the Commission to publish a general report on the experience acquired as a result of the operation of the ESAs by 2 January 2014, and every three years thereafter. Article 81(4) calls for an evaluation report and, if appropriate, a legislative proposal to accompany it should any change of the legal framework be necessary to allow the ESAs to fulfil their mandate and to ensure stability and effectiveness of the financial system.

The first Commission report on the functioning of the ESAs was published in 2014.<sup>14</sup> The report highlighted several areas that merited improvements, including through legislative changes. However, it was considered premature to propose legislative changes to the ESA Regulations after only three years of operations and with the regulatory and supervisory framework still in development. The 2017 evaluation report (see Annex 11.5) also identifies several areas which merit improvements. The evaluation demonstrates that EU action is justified and necessary to address identified problems in the area of powers available to the ESAs, their governance framework and their funding framework. Any actions in this respect will require amendments to the ESA Regulations. Furthermore, the results of the public consultation launched by the Commission in March 2017 provide further support to the conclusions made in the evaluation.

With regards to the adjustment of the powers of the ESAs the present impact assessment (see Chapter 6) demonstrates that certain powers of the ESAs can be improved and that amendments to the ESA Regulations will allow more consistent application of EU law, stronger supervisory convergence and will improve the functioning of the internal market, as foreseen in Article 114 TFEU. In some areas it has been not clear whether the ESAs have genuine powers to be involved and to assist the Commission on their own initiative. In all these cases the specific nature of these powers and the impact of the potential ESAs actions justify an initiative at EU level and amendment of the ESA Regulations.

Adaptations of the governance model of the ESAs would change their functioning, considered as means to improve harmonisation, and would therefore also be covered by Article 114 TFEU. The present impact assessment explores options for a more effective and efficient governance model which would serve better the protection of the EU interests in the ESFS.

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<sup>14</sup> Commission report on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS), COM(2014) 509 final, August 8 2014.

Moreover, as regards funding, Article 114 TFEU allows amendments of the funding framework to include funding through contributions from the industry. This is because the funding regime can be considered an integral part of the establishment of the ESAs themselves. Furthermore, where the industry's activity is considered potentially risky and where the tasks and the powers of the ESAs are intended to contribute to the containment of such risk, it is justified for the same industry to bear the costs arising out of the nature of its activity.

Finally, the ESAs are Union bodies whose powers and operation can only be amended by the Union legislator – in this case on the basis of Article 114 TFEU.

### **The choice of legal instrument**

The proposed legislative amendments that will follow on this impact assessment aim in particular at reinforcing the ESAs' framework. To this end the legislative measures will amend the current ESA Regulations to reinforce current powers of the ESAs, to create a more effective and efficient governance structure of the ESAs in line with other EU supervisory bodies such as the Single Resolution Board ("SRB") and the ECB/SSM, and to stipulate the general criteria for changing the current funding contribution. The latter will eventually also have to be implemented through a separate legal instrument detailing the implementation of the change in the contribution to the ESAs' funding.

There will also be amendments to various pieces of sectoral financial legislation to strengthen the ESAs' powers in areas such as e.g., third country equivalence and to centralize certain areas of supervision. As many of the necessary amendments would be minor changes to existing legal texts they could be summarised in an Omnibus Directive/Regulation.

The legal basis for the ESA Regulations is Article 114(1) TFEU. Any amending regulation will have the same legal basis.

## **5.1 General objectives**

The overall objective of the ESAs is to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system for the EU economy, its citizens and businesses. More specifically ESAs should contribute to:

- improving the functioning of the internal market, including, in particular, a sound, effective and consistent level of regulation and supervision;
- ensuring the integrity, transparency, efficiency and orderly functioning of financial markets;
- preventing regulatory arbitrage and promoting equal conditions of competition;
- ensuring that risks in their respective sectors are appropriately regulated and supervised; and



- enhancing consumer protection.

General objectives can be broken down in the following specific objectives:

- ensuring greater regulatory and supervisory convergence and more effective supervision with better defined powers for the ESAs (**S-1**);
- ensuring that ESAs' powers are coherent with other EU policies (e.g. CMU) and developments in EU financial integration (**S-2**).
- ensuring that ESAs have the proper incentives to effectively apply their powers and carry out their tasks in line with their mandates, and to take swift decisions in the EU interest (**S-3**).
- ensuring that the ESAs' annual funding is sufficient to meet their objectives in a sustainable way and in a way proportionate to the costs that all contributing parties generate (**S-4**)

Clear and fit for purpose powers, appropriate governance and sufficient funding for ESAs to meet their objectives are closely intertwined. Without appropriate governance and sufficient funding the ESAs will not be in the position to properly use their powers; at the same time broad powers alone might not be sufficient to achieve the ESAs' objectives if they do not avail of sufficient funding or if they are not governed in an effective and efficient manner.

## 6 Powers

### 6.1 State of play

One of the objectives of the ESFS (the ESAs, the national CAs and the ESRB) is to ensure that supervision of financial services and entities takes place at the appropriate level (national or EU level) and that the respective CAs are equipped with the necessary powers to execute their tasks.

The powers of the ESAs derive from the ESA Regulations. Sectoral legislation<sup>15</sup> further specifies when some of these powers can be used.

The ESAs' have three broad sets of powers:

- powers in relation to regulatory tasks, in the form of drafting Regulatory Technical Standards ("RTS") and Implementing Technical Standards ("ITS") and issuing non-binding guidelines, recommendations and opinions;
- powers to foster regulatory and supervisory convergence, where different competent authorities across the EU are in charge of direct supervision (including the possibility for the ESAs to ensure the consistent and proper application of EU legislation through, for example, dispute settlement powers and breach of Union law investigation and to conduct peer reviews);
- ESMA also has direct supervisory powers (including authorisation and ongoing supervision) over credit rating agencies under Regulation (EU) No 462/2013<sup>16</sup> and trade repositories under Regulation (EU) No 648/2012 (EMIR).<sup>17</sup>

Beyond the example of CRAs and TRs, supervisory powers of the ESAs directly applicable to market participants are limited and restricted to dispute settlements with a binding outcome, decisions taken as a result of a breach of Union law, and specific situations where certain financial activities have the potential to threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union and in cases of emergency identified by Council (Article 18 of the ESA Regulations).

### 6.2 Problem definition

The predecessors of the ESAs, the former Committees of Supervisors (i.e., the Committee of European Banking Supervisors, Committee of Insurance and Occupational Pension

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<sup>15</sup> The term 'sectoral legislation' is used in this report for Regulations and Directives regulating financial services and banking in the Union and to separate this body of legislation from the ESA Regulations which do not deal with the substance of financial services and banking but only with the establishment of the three ESAs. Sectoral legislation is nevertheless relevant for this impact assessment as it also allocates tasks and powers to the ESAs.

<sup>16</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0462>

<sup>17</sup> <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32012R0648>

Supervisors and the Committee of European Securities Regulators) had only an advisory role towards the Commission and coordination tasks in respect of the CAs. The ESA Regulations, therefore, represented a major strengthening of EU level supervision, in performing regulatory tasks and ensuring consistency in supervisory outcomes and in the application of EU law. Nevertheless, the regulatory and economic context has developed significantly since the powers of the ESAs were defined in 2010. Financial integration has progressed further<sup>18</sup> and there has been a very substantial amount of new legislation, notably:

- Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories ("EMIR"), effective since August 2012
- Short-selling Regulation (EU) No 236/2012, effective since November 2012
- Directive 2011/89/EU on financial conglomerates, effective since June 2013
- Single Rule Book of prudential requirements for banks capital, liquidity & leverage and stricter rules on remuneration and improved transparency ("CRD IV / CRR"), effective since December 2013 and January 2014, respectively
- New European supervisory framework for insurers ("Omnibus II") effective, since March 2015
- Directive 2014/49/EU on Deposit Guarantee Schemes, effective since July 2015
- Mortgage Credit Directive 2014/17/EU, effective since March 2016
- Strengthened regime on anti-money laundering, effective May 2017
- Enhanced framework for securities markets ("MIFID II/MIFIR"), effective as of January 2018
- Directive (EU) 2015/2366 on payment services in the internal market (cards, internet & mobile payments), effective as of January 2018
- Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, applicable from January 2018
- Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, applicable from 21 July 2019

These various pieces of sector legislation confer powers on the relevant ESAs, building on the respective ESA Regulation. In this context, it should be noted that, as a consequence of Article 1(2) of the ESAs Regulations, all the powers provided for those Regulations become applicable in respect of any Union act "which confers tasks on the Authority". Thus, the

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<sup>18</sup> See footnote 15 above.

responsibilities of the ESAs have significantly expanded since their establishment in 2011 and are set to expand further including in the area of retail markets, in years to come as indicated notably in the Communication on the mid-term review of the CMU Action plan and the Reflection paper on the EMU.<sup>19</sup>

In view of this expected expansion in responsibilities, the 2017 evaluation addressed the question whether the tasks and powers attributed to the ESAs have been appropriate. The evaluation concluded that the system has overall functioned quite well to date. However, there are concerns about whether the current framework is still appropriate in the perspective of the further intra-EU integration implied by the CMU, the completion of the Banking Union (BU) and the likely further integration between EU financial markets and the rest of the world as well as the fact that the currently by far most important financial market in the Union will become a third country soon. They are discussed as "Problem 1" below. In particular, the evaluation suggests a need for more common direct supervision by the ESAs in a few targeted areas as the most effective and efficient means to meet their objectives. This issue is discussed as "Problem 2" below. Such concerns about the definition and allocation of powers in the ESA powers are closely intertwined with two other issues: governance and their funding. Without appropriate governance and funding the ESAs will not be in the position to properly exercise any additional powers. However, it should be noted that the situation of each ESA has evolved differently amid the broader changes to the EU supervisory and regulatory framework so not all aspects of the two problems apply or will apply equally to the three ESAs.

### **6.2.1 Problem 1: ESAs cannot make proper use of some powers**

The evaluation suggests that the ESAs have not always been in a position to fully reach their objectives in respect of financial stability, market integrity and investor protection, partially because efforts to integrate EU financial markets have intensified in recent years. An important driver behind this problem is that some of the powers of the ESAs are not sufficiently well defined or are not sufficiently comprehensive.

As an illustrative example, when investigating an alleged breach of Union law, the ESAs can obtain information only from the competent authority under investigation and not from a wider range interested parties; this restriction limits the ESAs ability to build a case and effectively pursue their investigations. Similarly, the current dispute settlement provision has been criticised for not being sufficiently clear on when the ESAs can settle disagreements and that the effect of the current language goes too far in restricting the ESAs right to initiate or trigger dispute settlements with a binding outcome.

In relation to accessing information, the ESAs have mandates to foster transparency and consumer protection and one of the CMU commitments is to develop performance indicators on retail investment products. In this context, it is important that ESMA particular EIOPA can secure access to information from national CAs, which is not always the case. The preferred

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<sup>19</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017DC0139>

Option in relation to funding will also depend on the ESAs being able to can secure access to information that is needed to invoice relevant market participants.

Also in the area of internal models, inconsistencies remain between approved internal models of different (re)insurance (groups) despite the ongoing work on convergence within the current framework. A stronger role for EIOPA in this processes and ensuring it can have access to the necessary information on applications could foster further supervisory convergence in this area.

Yet another example is to be found in the area of equivalence. While sectoral legislation empowers the Commission to adopt equivalence decisions, it does not always indicate necessary follow-up action (for example, ex post monitoring of the regulatory and supervisory arrangements in third countries) after the equivalence decision has been taken.<sup>20</sup> In consequence, situations could emerge where a deterioration in regulatory and supervisory rules and standards in relevant third countries go unnoticed and create risks for investors, consumers and markets in the EU. While adverse situations may vary in recurrence, gravity or risk potential, the ESAs were initially established to deal effectively with them at EU-level. Therefore, solutions are needed to address the fact that ESAs are not able to exert powers they have due to insufficient means or otherwise and that their powers are not sufficiently well defined.

### **6.2.2 Problem 2: Absence of legal arrangements allowing for EU-wide supervision in some areas**

The current allocation of powers reflects an accumulation of sector specific decisions of the past years. In each case, new powers and tasks have typically been allocated to national CAs. This has created inefficiencies and will create further inefficiencies as market integration progresses, not least because of the CMU. These inefficiencies stem partly from different interpretation and implementation of rules by national CAs, but also from a lack of information and experience to assess cross-border situations and highly complex practices.<sup>21</sup> Moreover, market participants will find it difficult to reap the benefits of scale economies across borders when they are confronted with different implementations and interpretations in different Member States. This is sub-optimal in light of the need for greater convergence and to anticipate great market integration.

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<sup>20</sup> Third-country provisions exist in about 15 core pieces of EU financial legislation. These provisions empower the Commission to decide on the equivalence of foreign rules and supervision for EU regulatory purposes. The practical effect of a determination by the Commission through an equivalence decision is that a foreign regulatory, supervisory and enforcement regime is considered equivalent from a prudential point of view, to the corresponding EU framework, so that authorities in the EU to are able to rely on supervised entities' compliance with the equivalent foreign framework. It does not mean that the third country entities subject to the regime declared equivalent have access to the internal market.

<sup>21</sup> A case in point being internal risk models; the SSM in the Banking Union is able to compare models of banks from all across Europe (see the ECBs TRIM) program to identify and promote best practices, while for insurers and investment firms, such comparison is hampered because each individual national CAs is only confronted with few if any cases and will be unable to identify best practices.

Problem 2 reflects an increasing imbalance in supervisory competences between the national and EU level in view of EU's objective to further the integration of the financial markets through initiatives such as the CMU and the mid-term review thereof.<sup>22</sup> The drivers behind this imbalance are the growth in cross-border financial services and the increase in EU financial services legislation described above. The balance between the national and the EU level has shifted considerably in favour of the latter both with respect to economic activity and with respect to the level at which financial services and capital market participants are regulated. At the same time the balance of supervisory powers between the national and the EU level has hardly changed. The notable exception is the BU, which established the European Central Bank ("ECB") as the single supervisor of the euro area banking system and of the banking system of Member States that are not part of the euro area joining the SSM and the SRB as the single resolution authority.

Although financial market participants operate increasingly across the Single Market and a growing part of EU law is directly applicable, the powers of the ESAs in supervision are still almost exclusively indirect: the ESAs coordinate among CAs in supervisory colleges and try to enhance regulatory and supervisory convergence through dispute settlements, training, technical assistance, Supervisory Handbooks, peer reviews, and the like.

Furthermore, a significant share of cross-border activities in the integrated market is performed by a relatively small number of large financial actors like investment firms and many specialised asset managers. Especially for those actors and activities supervision at the national level seems sub-optimal. There is a risk that these actors would exploit differences not only in supervisory approaches but also in how the EU legislation is interpreted and applied. For example, there are concerns that home CAs might be less strict in enforcing rules, in particular on consumer and investor protection, in relation to activities carried out in Member States other than the home Member State. This might be due to constraints in (financial) resources or (language) skills or due to a lack of incentive or simply due to consumers or investors having problems to identify and to address the competent authority in another Member State.

A number of specific examples illustrate the fact that the current or envisaged supervisory approach (supervision at national level) risks creating problems (for further details, *see* Annex 11.6):

The business of data reporting service providers<sup>23</sup> is predominantly of a cross-border nature. Registration and supervision by national CAs risks being not fully effective as national CAs might not have the necessary capacity to detect, assess and monitor potential problems which might emerge in other Member States in relation to the activities of such data service providers. In particular, consolidated tape providers ("CTPs") and approved reporting mechanisms ("APAs") will gather trading data from providers across the EU (from trading venues where the trades take place and firms carrying out over the counter ("OTC") execution) and put it in consolidated streams to overcome market fragmentation/lack of

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<sup>22</sup> Commission Communication "Action Plan on Building a Capital Markets Union" (COM/2015/0468 final) and Commission Communication on the Mid-Term Review of the Capital Markets Union Action Plan, COM(2017) 292 final

<sup>23</sup> Regulation (EU) No 600/2014.

transparency. As these activities themselves are meant to overcome market fragmentation it would not be consistent to supervise them in a fragmented way at national level.<sup>24</sup>

There current discretion and divergent administrative practices among national CA in the authorisation and supervision of European long-term investment funds ("ELTIF")<sup>25</sup> as well as in relation to the registration and supervision of collective investment undertakings, or managers (e.g., European social entrepreneurship funds ("EuSEF") and European venture capital funds ("EuVECA")),<sup>26</sup> maintains certain barriers for the cross-border marketing of funds and does not ensure a full level playing field among fund managers in different Member States.<sup>27</sup> Furthermore, as for specialist issuers' prospectuses, in light of the limited number of these fund types their supervision at national level is not very efficient.<sup>28</sup>

The Benchmark Regulation envisages the creation of colleges of supervisors for the supervision of critical benchmarks to assist the relevant national CA of the benchmark administrator in the supervision.<sup>29</sup> Creating and running such colleges is a relatively time-consuming task, which is problematic in an emergency situation. It is unlikely that the national CA will have sufficient time to consult the other college members but will rather have to act quickly to avoid a disruption in the provision of the benchmark. In addition, it is likely that there will be several national CAs having to organise colleges. This organisational set-up therefore is suboptimal in terms of efficiency and effectiveness.<sup>30</sup>

The approval of prospectuses for specialist issuers by national CAs risks complicating the cross-border use of prospectuses and risks being inefficient as many national CAs would have to hire prospectus readers with the skills to deal with these relatively rare types of prospectuses. There is also a risk of supervisory arbitrage as issuers might target national CAs which they consider less demanding in order to get approval for prospectuses. The non-financial information items specialist issuers must disclose in their prospectuses is set out in an ESMA recommendation<sup>31</sup>, not in the implementing measures of the Prospectus Directive. In practise, this can allow for diverging applications by national CAs. There is a similar risk of supervisory arbitrage with regard to the approval of prospectuses for wholesale non-equity securities, asset-backed securities by national CAs as issuers would in most cases be able to choose the competent authority relatively freely.<sup>32</sup>

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<sup>24</sup> As the legal framework for some of the DRSPs will only be applicable when MiFID II applies in January 2018, there is no reliable indication yet as to how many such data service providers will seek authorisation, but there will be a sizable number of APAs. The more firms active in this field, the larger the challenge to ensure consistency.

<sup>25</sup> Regulation (EU) 2015/760.

<sup>26</sup> Referred to in Regulation (EU) No 346/2013 on European social entrepreneurship funds ("EuSEF") and in Regulation (EU) No 345 on European venture capital funds ("EuVECA").

<sup>27</sup> For sake of convenience, these three types of investment funds, EuVECA, EuSEF and ELTIF, will be referred to as 'European investment funds' in what follows.

<sup>28</sup> Currently there are 124 EuVECAs and less than 10 EuSEFs and ELTIFs.

<sup>29</sup> Article 20(1)(a) and (c), Regulation (EU) 2016/1011.

<sup>30</sup> Currently there are only two critical benchmarks. It is expected that this number might go up to about 20.

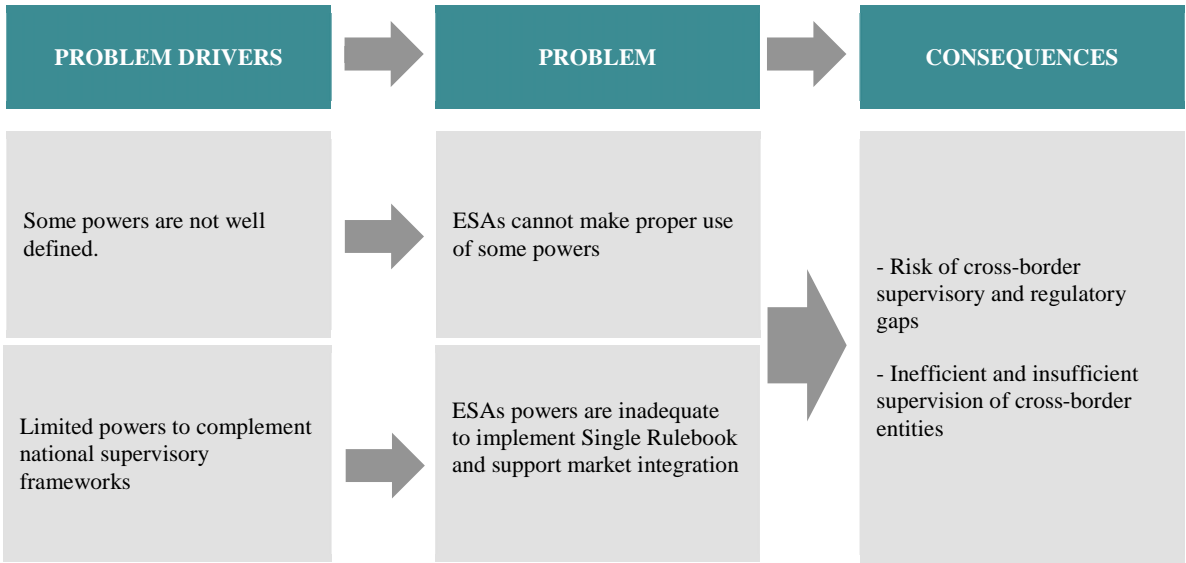
<sup>31</sup> ESMA update of the CESR recommendations (ESMA/2011/81).

<sup>32</sup> Regulation (EU) 2017/1129. On the basis of information provided by ESMA, this would cover about 1600 prospectuses (1100 wholesale prospectuses and 60 prospectuses from specialist issuers) in the Union.

Finally and in a similar vein, the approval of prospectuses drawn up by non-EU entities in accordance with Regulation (EU) 2017/1129<sup>33</sup> by ESMA (Articles 32 and 33 of Regulation (EU) 2016/1011)<sup>34</sup> by potentially 28/27 different national CAs carries the risk of supervisory arbitrage and is not very efficient in view of the duplication of resources in different national CAs for a few cases only.

Problem 2 has potentially similar consequences as Problem 1. It increases risks for consumers and investors, for market integrity and financial stability. These adverse impacts would become increasingly severe over time when and if markets integrate further and regulatory harmonisation of financial services progresses.

**Figure 6.1 Specific Problem Tree - Powers**



**6.3 Objectives**

The overall objective of the ESAs is to promote an effective and efficient supervision of the EU financial system, in particular with regard to cross-border activities and entities, which ensures financial stability and an appropriate protection of consumers and investors and the proper functioning of financial markets in the EU.

If these objectives are to be delivered effectively amid an increasingly integrated financial-market environment within the EU, it will be necessary to ensure:

<sup>33</sup> This Regulation will be applicable only as of 21 July 2019, but the current Prospectus Directive 2003/71/EC entails similar provisions. As no third country regime has been recognised as equivalent, there are no third country issuers with prospectuses drawn up under their third country national law. Third country issuers who wish to raise capital in the EU therefore draw up an EU prospectus in accordance with the Prospectus Directive. According to an ad-hoc survey in 2015, only 3 national CAs approved a total of 117 prospectuses from third country issuers in 2013 and 5 national CAs approved 119 such prospectuses in 2014; Luxemburg approving the lion share with 112 and 109, respectively.

<sup>34</sup> As benchmarks are currently not regulated in almost all countries of the world, there is no data about their number and even less so on the number of benchmark from third countries that are being used in the Union, but it can be assumed that the number is likely to be in the thousands. Many of these are, however, provided by a few 'major players'.



- greater regulatory and supervisory convergence and more effective supervision with better defined powers for the ESAs (S-1);
- that ESAs' powers are coherent with other EU policies (e.g., the CMU) and developments in EU financial integration (S-2)

Given that the regulatory framework and institutional architecture have evolved differently in various financial sectors, the nature of the changes in powers will differ among the three ESAs. For example, the creation of the CMU suggests the need for both enhanced powers to drive convergence and more direct supervisory responsibilities for ESMA, while the creation of the SSM and SRM within the BU imply less need for direct supervisory responsibilities for the EBA. Meanwhile, the level of progress in integration and in the insurance/pensions sector is different to that in banking and securities markets and hence the balance of powers between EIOPA and relevant national CAs is also different. Notwithstanding this, the advantages and disadvantages of various options for enhancing powers are otherwise basically the same in the case of the three ESAs.

<b>Problems</b>	<b>Problem drivers</b>	<b>Specific objective 1</b>	<b>Specific objective 2</b>
ESAs cannot make proper use of some powers	Some powers are not sufficiently well defined	√	√
ESAs powers are inadequate to implement Single Rulebook and support market integration	Limited powers to complement national supervisory frameworks	√	√

It is important to note that the achievement of these objectives will be closely linked to the problems related to the governance and the funding of the ESAs which are discussed in the following sections.

## 6.4 Policy options and impact analysis

Policy option	Description
1. No policy action	The baseline scenario applies – no change in the current powers of the ESAs.
2. Clarify certain existing powers and strengthen oversight over national CAs	Re-define current ESA powers that are not sufficiently clear and broad to allow the ESAs to fulfil their tasks and to achieve their objectives, in particular the promotion of supervisory convergence
3. Option 2 + provide ESMA with additional direct supervisory powers in targeted areas	Attribute new powers to ESMA, reflecting the importance of cross-border activities and the growing acquis of Union law in financial services
4. The ESAs as single supervisors in the Union	Centralise supervision in the area of financial services at Union level.

**Option 1 - No policy action.** Current powers in relation to regulatory and supervisory convergence tasks remain unchanged; as well as ESMA's direct supervisory responsibilities (baseline scenario).

**Impacts:** If the ESAs cannot have powers to make more progress in regulatory and supervisory convergence in all areas of financial services, participants in highly integrated markets might face a non-level playing field where rules are interpreted and applied differently in different Member States. This could result in higher costs for some market participants and distorted cross-border competition. Investors might be confronted with differences in protection, potentially without noticing this.

If the ESAs cannot ensure efficient collection of relevant data, costs would be higher for data contributors and users. CAs might detect problems belatedly or not at all. Problems with access to data were highlighted in the financial crisis in the aftermath of the collapse of Lehman Brothers investment bank. This could create or increase risks in financial markets and, in particular, for retail investors who do not have the possibility to monitor markets themselves but have to rely on the authorities.

If cross-border supervision does not keep up with the increase in cross-border activities, it might not be as effective as necessary to protect consumers and investors, as well as market integrity and financial stability. While colleges of supervisors help the exchange of information and should further convergence, their scope and efficiency is limited. The problems regarding data gathering and analysis might be aggravated. This would not only have adverse impacts for consumers and investors directly involved but would undermine trust in the Single Market. In the extreme, undetected risks might endanger market integrity or financial stability. This Option would therefore not help achieving the objectives. It is also not

coherent with the Union's objectives to promote market integration and to protect consumers and investors effectively.

**Option 2 – Clarify certain existing powers and strengthen oversight:** The ESA Regulations and/or sectoral legislation could be amended in certain parts in order to ensure that the ESAs can perform their tasks efficiently and effectively.

In particular, the ESAs' ability to ensure coherence in supervisory actions and in the application of EU law would be strengthened, by directing the legislator to conferring dispute settlement powers, including powers to take binding decisions, in a broader set of situations, not only upon request by a CA as is the case in many sectoral laws<sup>35</sup> and by making sure that they can access information to investigate alleged breaches of Union law. Enhancing the ESAs powers to ensure that they can access information necessary to pursue their tasks should also be done. Furthermore, the ESAs would be attributed the task of defining and steering supervisory actions of CAs regarding Union law. The ESAs would steer the focus of supervision in financial markets. They would agree on annual working programmes with the CAs and monitor their implementation and compliance with EU level strategic goals and standards. EIOPA's role in supervisory colleges should be strengthened to promote convergence in the assessment and approval of group internal models.

In addition, the ESAs will be tasked to help the Commission in the monitoring of compliance of third countries with equivalence requirements in sectoral legislation after Commission decisions on equivalence under sectoral legislation.

This Option would require legislative proposals amending the ESA Regulations and potentially some of the relevant sectoral legislation.

**Impacts:** These targeted changes could be implemented in a transparent and predictable manner based on updates to relevant legislation agreed by co-legislators. These changes would also result in noticeable improvements of the efficiency and effectiveness of the ESAs' work compared to the baseline scenario. They would help ensuring that going ahead with the creation of the CMU and the BU does not result in the "proliferation" of the supervisory gaps or shortcomings identified in the baseline. Closing these gaps by empowering the ESAs to address them would also be consistent and coherent with the Commission's various flagship projects. It would help to ensure consistent application of Union law and avoid the risk of regulatory arbitrage.

Clarifications would encourage ESAs to pay more attention to the respective areas and they would probably be more inclined to take action instead of having to lose time in discussions with CAs and/or the Commission to find out if the ESAs are actually empowered to take a certain action. This would close potential loop-holes in EU supervision which exist in the baseline scenario to the benefit of all supervisors and market participants as well as tax payers.

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<sup>35</sup> It should be noted however that the possibilities for binding mediation by ESAs cannot be applied in areas where MS have discretion, i.e. where the sectoral legislation provides some flexibility in its implementation, in particular in Directives.

Generally the clarifications and redefinitions of certain powers should not result in higher costs for the ESFS as a whole. In some cases there might be a shift of costs from national CAs to the ESAs if the changes were to trigger more activities by the ESAs and thereby reduce the work load of CAs. Overall, such shifts would be expected to result in a reduction of total costs as tasks would not have to be executed by several national CAs but by one of the ESA.

An increased role of EIOPA in relation to internal models would ensure a level-playing field among insurance groups as diverging SCRs can result in very different costs for the entities concerned. At the same time it would be much less disruptive than installing EIOPA as the sole authority looking into group internal models. The latter would also risk that approaches in the approval of group internal models and of other internal models might deviate. More consistent approaches to group internal models would also address wider macro-prudential concerns. Insurance policy holders would also benefit from fair competition, undistorted by differences in SCRs.

Closer oversight of the supervisory work of national CAs by ESMA would be an important step towards harmonised supervision of capital market participants subject to Union law. While national CAs would still be in charge of, and best placed for, the actual supervision, ESMA could promote best practices and a common implementation of Union law much more effectively. Divergences in the interpretation of Union law could be detected much earlier. However, this would require considerable additional resources for ESMA to gather the necessary high level of technical expertise and appropriate IT tools to manage the exchange of data and information between ESMA and national CAs. Member States would have to agree to a considerable reduction of the autonomy of their national CAs.

In comparison with the baseline scenario, Option 2 should lead to greater supervisory convergence and better application and compliance with EU law. As this would also reduce the scope for regulatory/supervisory arbitrage, supervision in the Union would become more effective.

### **Option 3 – Provide ESMA with additional direct supervisory powers in targeted areas.**

This Option adds upon Option 2, which comprises of horizontal measures concerning all ESAs, by empowering ESMA with the direct supervision over specific products, activities or actors in securities markets, which are already regulated at Union level but are still supervised at national level.<sup>36</sup> As the following areas are characterised by a large share of cross-border activity within the EU, as discussed in the problem description, supervision at national level cannot (always) ensure effectiveness and efficiency, in particular with respect to the impacts the respective activities might have in other Member States than the one of the national CA, the following task could be transferred to ESMA:

1. Authorisation and supervision of data reporting service providers (DRSPs) and a mechanism for trading data compilation from market participants and distribution to competent authorities

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<sup>36</sup> The transfer of additional powers to the ESAs would have to respect the limits set by the ECJ in its "Meroni" jurisprudence, which clarified that the powers granted to supervisory authorities had to be well-framed, leaving little room for discretion to the authority.

2. Authorisation and supervision of European long-term investment funds (ELTIF) and registration and supervision of collective investment undertakings or managers, as appropriate, referred to in the EuSEF Regulation and in the EuVECA Regulation
3. Supervision of administrators of critical benchmarks
4. Approval of prospectuses for wholesale non-equity securities admitted to trading on a regulated market or its specific segment to which only qualified investors can have access, asset-backed securities and specialist issuers, and control of all related marketing materials disseminated in the Member States where such prospectuses are used
5. Approval of EU prospectuses drawn up by non-EU entities in accordance with Regulation (EU) 2017/1129 and control of all related marketing materials disseminated in the Member States where such prospectuses are used
6. Recognition and approval of endorsement of third country benchmarks

### **Impacts:**

The impacts described for Option 2 would apply here as well. In addition, the following general impacts are expected:

Generally, the centralisation of certain tasks and powers, in particular those related to areas with a high degree of cross-border activities within the EU would lead to considerable gains in efficiency and effectiveness of supervision across the EU compared to the baseline scenario: In these more integrated parts of the financial services sector, centralisation of supervisory activity would promote market integration by reducing the costs of compliance for market participants as they would only have to deal with one supervisor while they currently often have to deal with national CAs in all Member States in which they want to market their products or services. Costs of supervision for national CAs would also be reduced as the number of entities, products or activities they have to supervise would be reduced. ESMA's costs would increase less than the significant savings from economies of scale and specialisation.

Also, when defining a response to prudential risk, a national CA might not take the EU-wide impacts fully into account or might not avail itself of all the necessary information and data this would render supervision less effective.

By attributing the supervision of certain actors or activities of a primarily or almost exclusively cross-border nature to ESMA similar effects would also be achieved within the EU. Similar to the case of credit rating agencies and trade repositories, ESMA would be charged with the supervision of certain activities which are almost exclusively provided across borders. This would reduce compliance costs and administrative barriers while enhancing the quality of supervision and contribute to the well-functioning of capital markets in general, to the opening up of new opportunities in the single market for investors, and to an improved access to finance.

Supervision would be improved as ESMA would have all relevant information about supervised entities or financial products at hand for the entire EU. It would be much better

placed to identify risks building up in the EU. This should increase confidence in the CMU by market participants and preserve financial stability.

The specific impacts of the proposed changes can be described as follows:

### **1. Authorisation and supervision of data reporting service providers (DRSPs) and enhanced data gathering powers**

Direct supervision of these data providers would spare national CAs from having to supervise a small number of entities across Member States. As the data is typically used by market participants and CAs across the EU and not only in individual Member States there is no important need for the supervisor to be close to the data provider.

As many APAs are likely to be entities set up by trading venues which are as such supervised nationally, a possible drawback of this option is that there is a risk that supervisory disputes might arise in this specific case as parts of a group might be supervised for some activities by the national supervisor and for others by ESMA. However, since trading and data provision activities are expected to be kept in in different entities, it should be easy for the supervisors involved to develop appropriate working arrangements. At the same time, the risk of having data stored in different formats in different Member States would be prevented. ESMA as central supervisor could better compare business practices and work towards best practices. Users of data across the EU (and beyond) could rely on fully harmonised approaches to supervision. In summary, supervision should be more efficient and effective if data providers were supervised by ESMA than if they were supervised nationally.

Finally, by conferring powers to collect trading data directly from market operators, ESMA would be a more efficient hub for compiling and processing and distribute trading data from across the EU necessary to design and apply technical rules and to monitor compliance with various transparency and reporting obligations. Market operators, end users and competent authorities would greatly benefit from such efficiencies since the current system of data distribution from multiple points (market operators) to multiple points (competent authorities) would be changed to a single flow of data via ESMA.

### **2. Authorisation and supervision of ELTIF and registration and supervision of EuSEF and EuVECA**

The objective of the EuVECA/EuSEF and ELTIF Regulations is to boost jobs and growth, SME financing, social and long-term investments but also to promote an EU investment culture. An appointment of a single EU supervisor would be fully in line with this objective and would further facilitate the integration and marketing of such funds across borders. Beyond this, single supervision would also address concerns regarding alleged differences in supervisory cultures and performance of different national competent authorities. The three funds are governed by EU sectoral regulations with no room for Member States' implementation gold plating.

As a potential drawback, some managers could manage next to EuVECAs, EuSEFs or ELTIFs other funds such as UCITS. Thus, they would need to be involved not only with ESMA but also with national CAs. However, already now managers may launch funds in different Member States, thus, are obliged to deal with different national CAs.

### **3. Supervision of administrators of critical benchmarks**

Having ESMA as the single supervisor of administrators of critical benchmarks would allow it to pool experience and to immediately trace potential adverse developments in the evolution of these benchmarks which are crucial for the EU economy and financial stability. All administrators of critical benchmarks would face the same approach of supervision. Users of critical benchmarks across the EU and beyond could rely on consistent and coherent supervision of such benchmarks.

### **4. Approval of prospectuses for wholesale non-equity securities, asset-backed securities, specialist issuers**

Specialist issuers (e.g., property companies, mineral companies, shipping companies) are a rare category where the relevant "sector" expertise could be consolidated with ESMA. As there are only relatively few prospectuses of specialist issuers, centralising the scrutiny of such prospectuses would allow building up expertise within ESMA. National CAs would not have to provision such expertise which is then hardly used and might therefore not always be developed in an optimal way. These types of issuers are typically required to disclose non-financial information items of a very specific nature (e.g. valuation of real-estate portfolio, details of mineral resources and reserves, anticipated mine life, details of patents and progression of product testing), which in turn requires skilled prospectus readers to scrutinise this information efficiently. In view of their low number, the scrutiny of prospectuses of specialist issuers would not represent a major shift in terms of resources from national CAs to ESMA.

Issuers would benefit as the ESMA prospectus readers would have a greater expertise, which would result in a swifter approval of prospectuses and in a more uniform level of quality of the scrutiny. This would facilitate cross-border use and ensure a level playing field among issuers. Investors would also benefit if a persistently high level of supervisory quality could be ensured. National CAs could free up resources which they otherwise would have to invest in these specific prospectus approvals. At the same time, some of them might consider this loss of competences as an adverse impact.

Charging ESMA with the approval of certain wholesale prospectuses (admitted to trading on a regulated market or its specific segment to which only qualified investors can have access<sup>37</sup>) and of ABS prospectuses could result in a significant streamlining of approval procedures, a reduction of the timeline for approvals and a welcome concentration of strategic expertise

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<sup>37</sup> These regulated markets or segments of regulated markets dedicated only to qualified investors are expected to develop and grow over time, potentially amounting for a significant number of future wholesale non-equity prospectuses.

with ESMA as in particular ABS is a complex type of securities. While the personnel implications of a move toward central ESMA approvals of certain wholesale and ABS prospectuses could be considerable, such a move would represent a unique opportunity to establish ESMA as a centre of expertise in the approval of CMU strategic prospectuses.

The impacts on issuers and investors would be similar to those for the other 'smaller' types of prospectuses. The impact on national CAs, however, would be bigger as their workload would be reduced. Here as well the loss of competence could be seen as an adverse impact. ESMA would require additional resources in terms of personnel, office and IT equipment and office space.

When offering securities to the public or requesting admission of securities to trading on a regulated market, issuers usually disseminate advertisements to the public in the form of marketing materials, in addition to the prospectus. The Prospectus Regulation requires the contents of such advertisements to be accurate, not misleading and consistent with the corresponding prospectus, and competent authorities are empowered by Regulation (EU) 2017/1129 to control the compliance of advertisements with this principle. As the supervision of advertisements related to prospectuses is currently an integral part of the role of competent authorities under Regulation (EU) 2017/1129, it is also logical to transfer to ESMA such a task in relation to all the aforementioned prospectuses whose approval is conferred to ESMA. To perform such a task, ESMA will need adequate staff resources with sufficient knowledge of the relevant national rules on consumer protection. Concentrating at ESMA level the control of advertisements for those prospectuses will ensure a level playing field and a consistent approach irrespective of where the advertisements are disseminated, and thus a high level of consumer protection.

## **5. Approval of prospectuses drawn up by non-EU entities in accordance with Regulation (EU) 2017/1129 and recognition and approval of endorsement of third country benchmarks**

As the BMR is only applicable as of 1 January 2018 and as third country benchmarks can be used in the EU until 1 January /2020 without authorisation or registration, only a few CAs in the EU will have experience with the supervision of such benchmarks in the next years. The endorsement or recognition of third country benchmarks by ESMA would therefore avoid that national CAs have to develop and maintain capacities for these tasks. Such capacities would instead be pooled in one authority which would allow to benefit from economies of scale and to exploit learning curves. This would ensure a harmonised approach vis-à-vis administrators of third country benchmarks, their contributors and their users in the EU. The risk of regulatory arbitrage, e.g., by influencing the determination of the Member State of reference through the choice of the entity requesting endorsement, would be eliminated. In its role of CA for third country benchmarks ESMA could deepen its relationships with third country supervisors. This would make cross-border cooperation more efficient and effective. ESMA would gather valuable experience which would allow it to better represent the EU's interests in international fora. Also, in view of the United Kingdom leaving the EU, a smooth but reliable third country regime would be crucial to ensure that the use of third country benchmarks by supervised entities in the EU is not unnecessarily disrupted once the transitional period of the BMR expires.



The approval of prospectuses drawn up by third country issuers entities in accordance with Regulation (EU) 2017/1129 by ESMA, and the control by ESMA of the corresponding advertisements disseminated in the Union by such third country issuers, would ensure a fully harmonised approach vis-à-vis third country issuers, would avoid cumbersome procedures to identify the relevant 'home Member State' and therefore would prevent forum-shopping. Third country issuers would have a single point of contact in the EU and would not need to deal with several national CAs if they offer different securities in different Member States.

For both tasks ESMA would require considerable additional resources. However, as this transfer of tasks would reduce the workload of national CAs, the total costs for supervision are not expected to go up by the full amount needed by ESMA. Yet, ESMA and national CAs would have to provision resources for the same tasks (but different issuers) in parallel. This might eliminate some of the savings which might result from a specialisation at ESMA in the respective regulatory and supervisory regimes in third countries and potentially smoother working arrangements with CAs in these countries.

Overall, this Option would obviously have strong direct impacts on ESMA. Its role in the supervision of market participants in financial services would increase considerably. To fill this role it would require considerable additional human and financial resources and would have to build up expertise in the respective areas. As some of the areas covered are not regulated to date or are being reformed currently, it is not possible to provide precise estimates of these resource needs. Based on experience of national CAs, it can be estimated that the tasks in relation to prospectuses would require about 15-20 FTE prospectus readers. While there is no reliable evidence regarding European investment funds per se data on the relation between the number of supervisors and the number of supervised funds in various national CAs suggests that 5 to 10 FTE would be necessary to supervise about 130 European investment funds. These very rough estimates suggest that ESMA would require probably around 100 FTE for the specific task of direct supervision. To this one would have to add the related overhead share and specialist support in the form of lawyers, accountants, etc. Such an increase in head count would at the same time require a considerable extension of ESMA's office space and office and IT equipment. But given the rapid growth of ESMA in the last years and that it is already the supervisor of credit rating agencies and trade repositories in the Union, it can be assumed that it could build on experience gained when it had to deal with these additional tasks.

It has to be stressed, however, that resulting financial needs of ESMA do not represent an equal increase in the costs of supervision of the respective activities but rather a partial shift of costs from national CAs to ESMA. In many cases, it can be assumed that the centralisation of supervision should lead to efficiency gains and therefore net cost reductions. Given that most national CAs are currently financed by the financial industry and provided that the direct supervision by ESMA would also be financed through fees as was the case of CRAs and TRs, costs to industry should not increase. For more detail on the various funding sources of the ESAs see chapter 8.

An advantage of this Option would be that it could be implemented incrementally. The transfer of powers in certain areas from national CAs to the ESAs would reflect the progress in market integration in the respective sector. If the ESAs were granted new direct supervisory

powers within the EU, this option would require a substantial increase in the budgetary and human resources of the ESAs in light of the extent to which supervisory powers would be transferred to them. This would potentially require a transitional period to allow the ESAs to equip themselves with the necessary skills and expertise. As they would potentially supervise entities in all Member States they would also have to enlarge their pool of language skills to be in the position to communicate with citizens and retail investors in all Member States. They might, at least in some areas, also have to acquire a certain degree of competence with regard to related national law, e.g., company law.

A disadvantage of this Option when compared with the baseline scenario would be that some actors might be supervised by an ESA for some of their activities and by national CAs for others. This could create additional costs especially for smaller market participants which are active only in one or a few Member States and require additional coordination between these supervisors.

Smaller market participants, and in particular citizens, might consider dealing with a central supervisor in a location potentially far away from their home Member State and not as familiar with the local language and context as the national CA as less convenient than the status quo (baseline scenario). Larger and internationally active entities, on the other hand, would most likely benefit from such centralisation and prefer this option over the baseline scenario.

Stakeholder views on this option are split. Respondents to the ESA public consultation have explicitly supported the direct supervision at EU level of CCPs<sup>38</sup> and of DRSPs which service the whole EU rather than specific national markets. Some also responded to the idea to put European investment funds under supervision by ESMA and partially supported it. Many respondents did not reply to the question on direct supervision. Replies to the question as to whether ESMA should be entrusted with direct supervision of pan-European collective investment funds mostly do not distinguish the different types of funds as proposed in this impact assessment report.

Views expressed **against** consolidation of ESMA supervision mainly refer to the following arguments: national based supervision was considered best suited to deal with the different market structures of Member States. Supervision by ESMA would conflict with national competence for retail investor protection and financial stability as well as taxation, litigation and conflict resolution. Operational difficulties such as control of local requirements related to distribution arrangements or marketing were also raised. Instead, existing tools to ensure supervisory convergence should be better explored to develop integrated capital markets.

The main arguments **in favour** of direct supervision by ESMA mentioned were: some respondents recognised potential merits in ESMA supervision over entities or instruments

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<sup>38</sup> A Commission proposal on CCPs has already been adopted and is therefore not discussed in this impact assessment. It introduces a more pan-European approach to the supervision of EU CCPs, to ensure further supervisory convergence and accelerate certain procedures. ESMA will be responsible for ensuring a more coherent and consistent supervision of EU CCPs as well more robust supervision of CCPs in non-EU countries.

with a pan-European dimension which would allow coordination of supervisory practices, taking into account different market structures and thus, reflecting the principles of subsidiarity and proportionality. They considered that such solutions were appropriate to address the problem of fragmentation and inefficiencies of current regime as well as regulatory arbitrage and divergent application of EU rules.

Finally, this option would be subject to the limits imposed by primary law, as interpreted by the Courts, on the delegation of powers to EU bodies, as opposed to EU institutions. Whether these limits are complied with in the present context must be judged notably in light of the breadth of discretion the substantive rules imply, as regards action by supervisory authorities.

**Option 4 – Turn ESAs into single supervisors in the EU:** The supervision of financial services, banking and insurance would be centralised in the three ESAs. This option has already been discussed in the 2009 impact assessment and discarded at that time. However, with the creation of the SSM in 2013, a step in this direction has already been taken in the field of banking where the ECB has been installed as the single supervisor of banks in the euro area and in Member States which have joined the SSM.<sup>39</sup> In light of the developments discussed under Problem 2, it seems appropriate to reconsider this assessment. The single supervisors could be organised as strictly central units or partially decentralised with offices or branches in all Member States either serving as contact points for (retail) investors and potential complainants as well as the supervised entities, or (partially) performing the supervision on the spot. Also the model of the SSM could be envisaged, where supervisory competence is centralised but the national CAs continue to exist and contribute to the functioning of the supervisory mechanism in different degrees depending on whether the supervised entity is more or less significant. This option would require legislative proposals amending the ESA Regulations as well as all relevant sectoral legislation.

**Impacts:** This Option would reduce costs of supervision considerably because it would no longer be required that competencies for all supervisory tasks in all areas are ensured separately in all Member States and because of a reduction of costs of coordination among CAs and with ESAs. It would exploit economies of scale to the full and avoid the duplication of tasks. However, transition costs could be considerable as ESAs would have to build up human capacities and would need much more office space. Depending on the funding of the regime (*see* section 8) the absolute expenditure for the EU Budget could increase considerably while total costs for Member States would most likely be reduced in comparison with the baseline scenario.

For legal reasons, these advantages would not in fact be available in full. As mentioned above, delegation of powers to an EU body is subject to the limits imposed by primary law. The greater the number of sectors covered, the higher the likelihood that, among the substantive rules concerned, there are some at least that could not be subject to direct supervision by an EU body (as opposed to an institution). At this point in time, difficulties would also result from the degree of harmonisation of the material regulatory requirements in some sectors. To illustrate, the SSM as a single supervisory mechanism was created in an area

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<sup>39</sup> With regard to the banking sector the allocation of tasks between EBA and ECB could also be re-considered.

where material requirements are largely fully harmonised in directly applicable regulations; nevertheless, remaining areas where material requirements are still implemented through national law or where directly applicable Regulations entail national options and discretion have led to inefficiencies in the SSM's operations.

Even if legally possible, this Option would imply that the pros and cons of Option 3 would be extended to all sectors and actors: major international actors would probably be the main beneficiaries while smaller financial actors and retail investors might suffer from a lack of proximity of the supervisor to the market. Member States and their CAs would have less direct influence on the financial sector in their jurisdictions.

Overall, this option seems to go beyond the optimal degree of centralisation required as some supervisory tasks are better performed by a supervisor close to the idiosyncracies of the regulatory framework at national level and close to the local market itself. This holds true for example for a local investment firm or bank serving only clients in a local market. Full centralisation seems inappropriate in such a scenario. A "hub and spokes" system like the SSM could, while achieving full coherence in the supervisory work, mitigate the problem of remoteness from the market but would find it difficult to overcome a lack of regulatory harmonisation. Some stakeholders also raised the questions of accountability and liability of single supervisors. Comparing the options

**Table 6-1. Comparison of policy options against effectiveness and efficiency criteria**

Objectives Policy options	EFFECTIVENESS		EFFICIENCY (cost-effectiveness)
	Objective 1: supervisory convergence and more effective supervision	Objective 2: enhanced investigations and control of compliance	
Option 1: No policy change	0	0	0
Option 2	+	+	+
Option 3	++	++	++
Option 4	+	++	+

*Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable*

In comparison to Option 1 (baseline scenario), Option 2 would not significantly improve the allocation of powers between CAs and ESAs. It would nevertheless be helpful as it would avoid supervisory gaps and allow ESAs to achieve their objectives. This in turn would make their work more efficient and effective. This Option, while in principle coherent with the

overall objectives of the EU's policy in the area of financial services, is reaching its limits in view of the full harmonisation of capital markets. As for the Banking Union, sheer coordination at Union level seems no longer sufficient to ensure an efficient and effective supervision of international players and products in the CMU.

Option 3, additional direct supervisory powers for the ESAs, would achieve both objectives much better than Option 1 and also than Option 2. It would therefore also be more efficient and effective, in particular when introduced incrementally in areas showing clear benefits of central supervision. It is more effective than Option 2 as it avoids the increasing risks of adverse cross-border impacts going unnoticed by national CAs and more efficient as it exploits economies of scale. This Option would also be coherent with the overall objectives of the EU's policy in the area of financial services but would have to be carefully calibrated in its interactions with the SSM.

Option 4, single supervisors, would most likely have significant positive and adverse impacts which might net out to a large extent. While, for example, the centralisation of all supervisory powers would shift the supervision of relevant cross-border and non-EU activities to a more appropriate level, it might at the same time move the supervision of smaller actors and purely national activities too far away from the optimal level. This could compromise the effectiveness of supervision. Similarly, there would efficiency gains in some areas, e.g., data collection and analysis and supervision of major actors, but there would also be risks of losses in efficiency if tasks were first centralised but had then to be delegated back to local offices. In the current context, this Option might therefore not be fully coherent with the overall objectives of the EU's policy in the area of financial services.

For the current situation, Option 3 is therefore the preferred option. It could, however, be envisaged that in the long term Option 3 would pave the way for a single European capital markets supervisor.

## 7 Governance

### 7.1 State of play

The three ESAs currently have an identical governance structure which comprises: (i) a Board of Supervisors; (ii) a Management Board; (iii) a Chairperson; and (iv) an Executive Director.

The Board of Supervisors is the main decision-making body of each ESA. It consists of the Chairperson, the head of the national CA in each Member State<sup>40</sup>, and one representative each from the Commission, the ESRB, the other two ESAs, the EEA-EFTA States and the EFTA Surveillance Authority.<sup>41</sup> Only the representative of the national CAs can vote. National CAs, which are integrated supervisors, participate in more than one ESA.

Decisions by the Board of Supervisors are generally taken by simple majority. However, QMV is used in the case of "regulatory decisions" under the founding regulations (Articles 10 to 16 of the ESA Regulations), such as decisions relating to RTSs and ITSs, guidelines (Article 16) and recommendations, budget matters, and in cases of a decision to prohibit or restrict certain financial activities. The rationale for using QMV in the case of regulatory tasks is their similarity to legislative tasks, for which decisions are taken in the Council with QMV. For decisions taken in relation to "non-regulatory" tasks (e.g. Breach of Union law processes, dispute-settlement, peer reviews) simple majority voting applies. Where ESMA has direct supervision powers (currently CRAs and TRs), simple majority voting applies. The voting system within the EBA was modified after the creation of the SSM to better take into account Member States which do not participate in the BU. For instance, some EBA decisions require, in addition to the general majority requirements, a simple majority of national CAs participating in the SSM and a simple majority of national CAs not participating in the SSM, respectively ("double simple majority"). The regulation also foresees a mechanism to ensure that this system remains workable when the number of non-participating Member States decreases, as would be the case if more Member States join the Banking Union, or as the UK leaves the EU.<sup>42</sup> In addition, the Regulation foresees that the Commission should review the voting arrangements when there are less than 4 non-Banking Union countries.

The Management Board is composed of the Chairperson and six members of the Board of Supervisors. It is mainly in charge of the ESA's work programme but also plays a central role in the adoption of the budget. An Executive Director and a representative of the Commission participate as observers and the Commission has a right to vote on budget matters.

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<sup>40</sup> These representatives are the heads of national competent authorities who have been appointed through national processes and are accountable to their respective national government and parliament.

<sup>41</sup> In the case of the EBA, the Supervisory Board of the ECB participates as a non-voting member. In addition, the Chair of the SRB acts as an observer when resolution matters are dealt with by the Board of Supervisors.

<sup>42</sup> When four or fewer voting members are from competent authorities of non-participating Member States, decisions shall be adopted by a simple majority of the voting members of the Board of Supervisors, which shall include at least one vote from members from competent authorities of non-participating Member States.

The Chairpersons of the ESAs' Boards of Supervisors are appointed by the Board of Supervisors following an open selection process and a hearing before Parliament. The Chairpersons' formal tasks comprise the preparation of the work of the Boards and chairing the Board meetings. They do not have voting rights.

## 7.2 Problem definition

The analysis has been treating the ESAs symmetrically in terms of problem definition and policy options. This is justified by the fact the ESAs have a symmetric governance structure. However, there exist some specificities among the ESAs, notably the differing tasks that ESAs have (i.e. the governance of direct supervision of certain market segments for ESMA), or specific governance features (e.g. the voting system that was introduced in the EBA to reflect the creation of the SSM). Some further differentiation may therefore be warranted, to better take into account the different mandates and tasks of the three ESAs. This will be highlighted throughout the text.

An optimal governance structure should allow the decision-making bodies of the ESAs to fully achieve their objectives by making full and appropriate use of their powers with a view to ensuring that financial supervision in the EU is consistent and coherent. Under such a structure, the ESAs should first of all have a sufficiently broad and EU-wide perspective to be in a position to identify shortcomings and, secondly, be willing to address them by using their powers. The objectives of the ESA Regulations can only be achieved if both conditions are met.

The main issue with the current governance structure of the ESAs is that there is an inherent misalignment of incentives within the decision-making bodies of the ESAs, which may lead to conflicts of interests and limits the development of an EU perspective in favour of a national one. The scope for such conflicts of interest is set to increase as progress in integration proceeds across all financial sectors and notably in securities market in the context of the CMU.

When the ESAs were established, it was decided to maintain a key role for national CAs within their governance structure, while specifying in the legislation that members of the Board of Supervisors and of the Management Board should act independently and in the sole interest of the Union as a whole. This would prevent conflicts of interests. For example when voting on dispute settlement issues, the representatives of CAs involved would be expected to vote in different directions, thus eliminating each other.<sup>43</sup> However, the initial governance structure of the ESAs did not provide for other safeguards to ensure that this would be achieved in practice. In particular it did not include specific structural provisions to preclude risks of conflicts of interest.

This is an issue because decisions are exclusively taken by national representatives on the Boards of Supervisors, who have to combine their mandate within the ESA with their national

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<sup>43</sup> See the 2009 Staff Working Document accompanying the proposal for Regulations establishing the ESAs, p. 32.

mandate as heads of national CAs. As a result of this double mandate they may have conflicting interests, notably as regards decisions that may affect their national CA and/or market. A national CA may for example have a strong tendency to take a national perspective in the event of a procedure regarding an alleged breach of Union law under Article 17 of the ESA Regulations. This does not necessarily imply that the ESAs have generally not considered the EU-interest in their functioning, but in certain instances the governance structure had an impact in the way the ESAs have been using (or not) their powers.

In other institutions and agencies, conflicts of interest between the EU and national levels have been addressed by specific governance arrangements, involving full-time independent members to steer decision-making in an impartial and efficient manner. For example, the European Central Bank and the Single Resolution Board both have Executive Boards comprising such independent members. The ESAs have no stable independent preparatory body, which has own powers and tasks, and can decide on certain issues or participate in the decision-making process.

The absence of a stable preparatory body within the ESAs has led to various calls for changes to the governance structure throughout past consultations.

- The Parliament recommended in the 2013 report on the ESAs review<sup>44</sup> to enhance the performance of the ESAs by introducing operational improvements in the governance structure (i.e., creating an Executive Board with more operational tasks) and by raising the institutional profile of the Chairpersons (i.e., granting the Chairperson voting rights and changing the appointment procedure).
- The IMF<sup>45</sup> also called for changes in the governance arrangements for the ESAs, with the aim of strengthening their operational independence and effective accountability, which would help to overcome the domination of national interests in decisions of the Boards of Supervisors and facilitate rapid decision-making.
- This was also recognised in the November 2014 ECOFIN conclusions on the ESFS<sup>46</sup> where it was noted that considerations should be given as to "how to improve the governance of the ESAs to ensure that decisions are taken in the best interest of the EU as a whole while preserving the careful balance reached in the context of the establishment of the SSM, having regard to the expertise provided by the national competent authorities".
- In his speech at the Parliament hearing on 3 May 2017<sup>47</sup>, Jacques de Larosière shared the assessment that in some circumstances the ESAs have not been able to obtain a consistent implementation of some technical rules, and argued that enhancing the current Management Boards into Executive Boards with independent permanent

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<sup>44</sup> [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507446/IPOL-ECON\\_ET\(2013\)507446\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507446/IPOL-ECON_ET(2013)507446_EN.pdf)

<sup>45</sup> IMF Country Report No. 13/65, March 2013.

<sup>46</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/145696.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/145696.pdf)

<sup>47</sup> <http://www.europarl.europa.eu/cmsdata/117822/Written%20statement%20Jacques%20de%20Larosiere.pdf>



members with decision-making powers on issues such as binding mediation and on-site inspection would help the ESAs in promoting the European interest.

- A number of stakeholders in the public consultation also considered that there would be merit in making changes to the governance structure to address potential inherent conflicts of interest. To note, this view was the least shared among public authorities (including those currently participating in the ESAs' Boards), which can to some extent be attributed to them not wanting to see their influence diminish.

The potential for conflicts of interest between the EU and national mandates held by members of the ESAs can be attributed to a combination of factors (problem drivers) intrinsic to the different parts of the governance structure:

- **Decision-making powers on the Board of Supervisors are restricted to national competent authorities:** The current structure of the Board of Supervisors favours the prevalence of national perspectives which may influence decisions accordingly, as voting rights are restricted to representatives of national CAs. Meanwhile, the Chairperson and the representatives of the Commission, ECB and ESRB are non-voting, and there are no permanent independent voting members on the Board of Supervisors.<sup>48</sup> This implies that an inherent EU perspective is both numerically underrepresented and carries no weight in terms of votes. This set-up may dissuade the ESAs from taking decisions that affect individual national CAs. Such inaction biases may limit the progress in supervisory convergence and slow down enforcement.
- **The appointment procedure of the Chairperson makes him/her dependent on the Board of Supervisors.** Given that the Chairperson is appointed by the Board of Supervisors, this may favour "group thinking".
- **The Management Board is composed of national Competent Authorities.** As a subset of the Board of Supervisors, the Management Board faces similar problems as the Board of Supervisors, regarding the national perspectives and disincentives to take decisions that affect individual members. Stakeholders in the consultation also noted that the rotation of membership of the Management Board hinders the emergence of a coherent executive function. This is corroborated by the fact that there are no permanent members in the Management Board, which can fully dedicate their time to the tasks assigned to the ESAs. Rather, members of the Management Board also hold important functions within the national CA, which may have an impact on their material time commitment to the Management Board. The frequent rotation among Management Board members may therefore negatively affect continuity and weigh on the long-term perspective taken by the Management Board.
- **The Management Board and the Chairpersons do not have formal powers.** All decisions are taken by the Board of Supervisors while the Management Board and the Chairpersons are not attributed specific tasks. In particular, the Management Board

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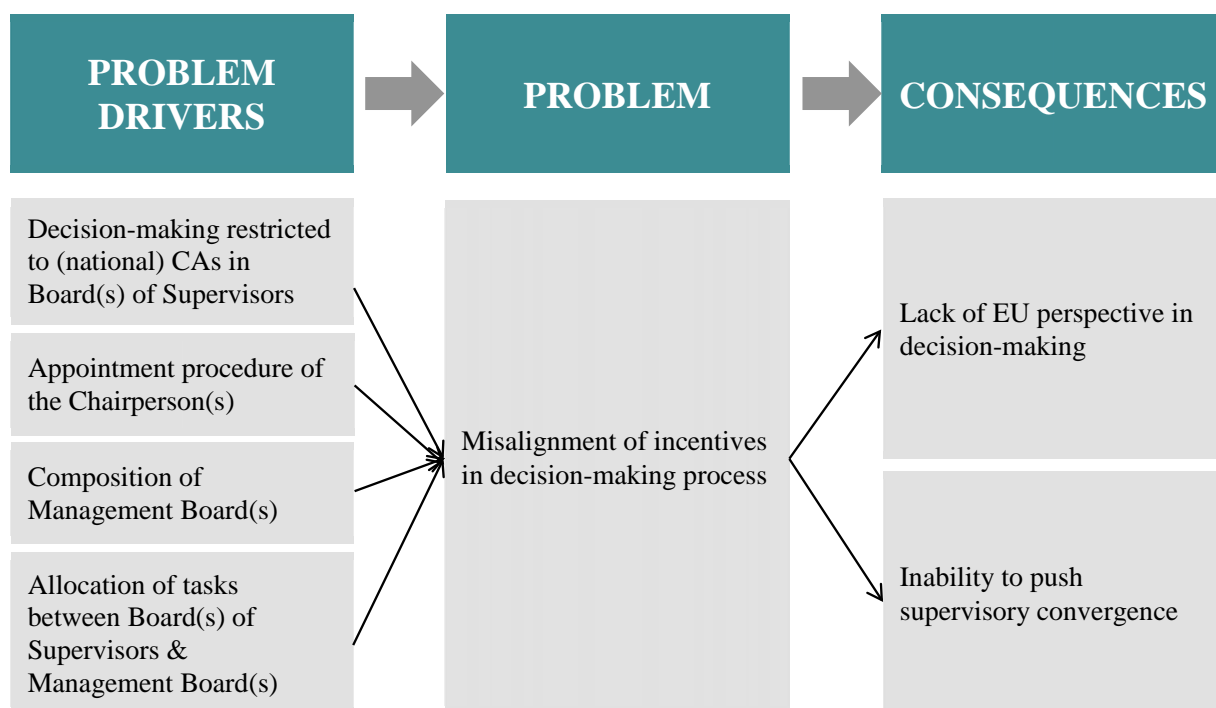
<sup>48</sup> However, it should be noted that in the area of exclusive competence of the ECB, national authorities have to follow the ECB's instructions when voting at the EBA Board of Supervisors. The problem highlighted here may therefore be less pronounced in this area.

has no formal role as regards the initiation of procedures that lead to ESA decisions, notably breach of Union law decisions, which contributes to an ineffective decision-making process. Indeed it appears that formally only few tasks are delegated to the Management Board, while the Board of Supervisors often faces a high workload, which may prevent it from dedicating its efforts to strategic issues or supervisory matters in general.

However, it should be noted that any assignment of wider competences to the Management board would need to take into account that it is, in fact, a subset of the Board of Supervisors. Failing an amendment to the existing rules, the problems identified above in respect of the Board of Supervisors (national perspectives and disincentives to take decisions that affect individual members) would also affect the Management Board.

Regarding the Chairpersons, while it is generally recognised that they have fulfilled their missions in an effective manner and supported the profile of the respective ESAs, their formal role and powers is very limited as they do not have voting powers nor formal tasks. To note, the current legislation allows for the possibility to delegate powers to the Chairperson. However, this possibility has not been used, which may be a further illustration of the incentive structure within the ESAs which tends to concentrate powers in the hands of national CAs rather than delegating or seeking a more independent approach.

Figure 7.1 Specific problem tree



The identified problems in the governance structure lead to a number of adverse consequences (see problem tree above) that are likely to intensify as financial markets become more integrated and the balance between the EU mandate and the national mandate of ESA members, respectively, shifts in favour of the former.

**First, there is a lack of an inherent common perspective in the decision-making of the ESAs that may slow down progress, notably as regards convergence** (see below). Instead, the decision-making process is strongly influenced by individual national perspectives. For example, EBA staff has recognised that potential conflict of interest may arise given the fact that board members are representatives of national public authorities, which have national objectives. For instance, a voting member cannot vote on a matter where he/she has a material personal conflict, but it does not prevent him/her from voting on a matter concerning its own competent authority.

**Second, while the ESAs have delivered well on their tasks of a regulatory nature such as RTSs and ITSs, there is scope for further progress regarding their tasks to promote supervisory convergence and ensure the proper application of EU law ("regulatory convergence").**<sup>49</sup> In this context, it should be noted that convergence powers of the ESAs (e.g., peer reviews, breach of Union law procedures, dispute settlements) can be seen as more intrusive and having more direct effects (hence potentially leading to a more cautious action

<sup>49</sup> See for instance the European Parliament's report on the Review of the New European System of Financial Supervision (ESFS): Part 1, p. 115.

on the part of national CAs) compared to regulatory tasks. Furthermore, and contrary to non-regulatory tasks, the ultimate competence for the regulatory tasks lies with the Commission, the ESAs work in this area being essentially preparatory in nature. The misalignment of incentives would therefore have more direct impact on the ability of the ESAs to use these non-regulatory powers. To note, the EBA in its reply to the ESA public consultation made the point that if changes would be introduced to the governance set-up, these should primarily concern areas in which the decision-making process could turn out to be very difficult or influenced by national biases, such as dispute settlements or breach of Union law processes. This is corroborated by stakeholders' perceptions expressed in the public consultation, which suggest that regulatory tasks in particular have been carried out in a satisfactory manner, while more could be done in the areas of regulatory and supervisory convergence.<sup>50</sup> For example, there have so far been no cases of dispute settlements with binding outcome adopted by the ESAs. Furthermore, the use of peer reviews has been limited and primarily thematic. There have been no formal recommendations following the identification of a breach of EU law, even in cases where this was expected by some stakeholders.<sup>51</sup> The ESAs have thus so far focussed on their regulatory tasks such as drafting RTSs and ITSs. This can be partly explained by the need for prioritisation given scarce resources and by the fact that the ESAs were established at a time when the EU financial legislation was profoundly overhauled, implying a high workload for the ESAs as regards regulatory matters. However, as described above, the governance structure of the ESAs is inherently not conducive to an effective use of some of their powers<sup>52</sup>, hence impacting on the ESAs ability to fulfil some parts of their mandate effectively (e.g. regarding the ability to progress with convergence).

**These two consequences will become even more relevant in a context where the ESAs will have to play an increased role given the objective to increase financial integration and the exit of the United Kingdom from the EU.** The current governance set-up may put the ESAs in an ill-equipped position to face upcoming challenges. Two main issues are indeed enhancing the need for convergence going forward: the CMU and the exit of the United Kingdom from the EU, which will both have an impact on the structure of the EU's financial sector and therefore call for the ESAs to be able to fully play their role. The CMU initiative will lead to deeper financial integration in the EU capital markets and will entail a progressive shift to more market-based financing of the economy and deeper financial integration in Europe. To promote enhanced financial integration and reap the benefits of it, the CMU should be accompanied by increased convergence across the EU to ensure consistency in the application of capital markets rules and the oversight of market participants, particularly in cross-border and critical areas. In addition, the risks of regulatory arbitrage and regulatory or supervisory race to the bottom, notably in the context of possible

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<sup>50</sup> Stakeholders have perceived a certain reluctance to act. To illustrate this, EBA has delivered a total of 144 technical standards (TS) from 2011, corresponding to 85% of those required to be developed. Meanwhile, EIOPA delivered all ITS requested by the legislation, even though one was not adopted.

<sup>51</sup> See for example the European Parliament (ECON) study on the review of the ESFS – Part 1 review of the ESAs.

<sup>52</sup> See stakeholders' replies to the Commission's 2014 Review Report, the Commission's 2014 Review Report, the European Parliament's 2013 Review Report of the ESFS, the IMF Country Report No 13/65 on the Financial Sector Assessment of the EU.

relocations of financial firms following the United Kingdom's exit from the EU, increases the need for enhanced supervisory convergence across the EU.

As a conclusion, given its initial design, the current governance structure of the ESAs may hamper the effective and adequate use of some of the powers, notably regulatory and supervisory convergence. As such, enhancements to the current governance structure are necessary going forward, notably to avoid a possible inaction bias.

### 7.3 Objectives

The **objective** behind the review of the governance framework is to ensure that the ESAs have the proper incentives to effectively apply their powers and carry out their tasks in line with their mandates, and to take swift decisions in the EU interest so that the ESAs have the appropriate governance structure to also face upcoming challenges. In particular, it aims at ensuring that misalignments of incentives in the decision-making process are corrected.

Problems	Problem drivers	Objective
Misalignment of incentives in decision-making process	Decision-making restricted to (national) CAs on Board(s) of Supervisors	√
	Appointment procedure of the Chairperson(s)	√
	Management Board(s) made up of (national) CAs	√
	Allocation of tasks and powers between Board(s) of Supervisors and Management Board(s)	√

### 7.4 Policy options and impact analysis

This section describes the details and the potential positive and negative impact of two alternative high level policy options to address the problem identified in the current governance structure. These high-level options will be compared against the baseline scenario that the current governance structure remains in place. On that basis, the preferred option will be refined along a number of sub-options in section 7.6. While the analysis sought to identify the best options for the three ESAs as a whole, it also highlights where a differentiation is needed to take into account the specificities or challenges faced by an individual ESA.

Policy option	Description
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1. No policy action	The baseline scenario applies.
2. Targeted changes to the current governance model	Targeted changes to individual elements of the governance would be introduced. Decisions on certain non-regulatory issues would be allocated to decision-making bodies including independent members.
3. Fundamental rebalancing of decision-making powers within the ESAs	Decision-making powers on all decisions would be transferred to full-time independent members at the core of the ESAs.

### 7.4.1 Baseline scenario

**Option 1 - No policy action** – The baseline scenario applies. No modifications to the current governance structure.

Under this option, the governance structure of the ESAs as it currently exists would be maintained, implying that the misalignment of incentives in the ESAs decision-making would prevail. Most notably, the prominent role of the national CAs in the decision-making would be kept, as well as the appointment procedure and current roles of the Chairpersons and the Management Boards. The consequences of the problems posed by the current governance model would likely become more pronounced going forward given the change in context in the EU with more financial integration (as a result of the CMU initiative).

The main advantage of the current governance structure is that it arguably ensures buy-in of national CAs and also reflects the fact that certain elements, such as national specificities and laws, still play a key role in the functioning of the Single Market.

However, the disadvantage is that keeping the current governance structure would leave the identified problem largely unaddressed. The absence of independent members in the decision-making process would maintain the misalignment of incentives inherent to the decision-making set-up of the ESAs, as national representatives on the Board of Supervisors would occasionally still be torn between their national and their ESA mandate, respectively, which could prevent them adopting an EU perspective in their decision making. Given that the current governance set-up has proven not to be the most effective in terms of allowing the ESAs to fully achieve their objectives by using their power in the area of supervisory convergence, and given the increasing importance of this area going forward, maintaining the status quo would make the existing problems even more relevant. In addition, there is room for increasing efficiency of decision-making processes within the ESAs, for instance to address the current overburdening of the Boards of Supervisors impeding the conduct of thorough discussions during its meetings.

When the United Kingdom leaves the EU, the number of members in the Board of Supervisors will be reduced. In the case of EBA, the current double majority system by which a decision requires the majority of votes both from national CAs from the Member

States within the BU and outside the BU should be assessed in this light. Looking at the double-majority provisions in the EBA Regulation, it might be argued that the rationale for such a safeguard diminishes with the exit of the United Kingdom and it might be seen as giving a disproportionate power to an increasingly small number of Member State CAs (notably as other Member States are expected to join the BU in the future). However, without such a Single Market safeguard, the role of the EBA would be reduced to applying decisions taken by Member States participating within the SSM (the BU) which would always have the majority of votes. Given that the added value of the EBA is specifically to have a broad EU perspective for the Single Market as a whole, maintaining safeguards for considering the interests of non-BU Member States is justified. In addition, for certain decisions such as dispute settlements and breach of Union law proceedings, the EBA Regulation already provides for safeguards to ensure that the double-majority system remains workable in the case that the number of non-BU Member States becomes less than four.

#### 7.4.2 Targeted changes to the current governance model

<b>Option 2 - Targeted changes to the current governance model</b>
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Under Option 2, decision-making powers would be split by their nature and allocated to separate decision-making bodies within the ESAs. This would build on the differential treatment that already exists currently with decisions taken in respect of regulatory tasks by QMV and non-regulatory decisions by simple majority. Decision-making powers on regulatory issues would remain fully with the Board of Supervisors, while certain decision-making powers on non-regulatory issues (such as peer reviews, dispute settlements, breach of Union law procedures) would involve permanent, independent members. Furthermore, the EU dimension in the ESA governance would be strengthened by enhancing the selection procedure of the Chairperson and opening up the Board of Supervisors to independent, permanent (non-voting) members.

Adjustments would be made to four key components of the ESAs' governance:

- **enhancement of the EU dimension in the decision-making process within the Board of Supervisors** by adding independent members who would not face conflicts of interest.
- **transformation of the Management Board into a body with independent members.** This body would steer decision-making in an impartial and efficient manner and could also take up decision-making responsibilities, notably for non-regulatory decisions.
- **enhancement of the standing and role of the Chairperson** to empower him/her with formal tasks.
- **allocation of decision-making powers in relation to certain non-regulatory tasks to a decision-making body comprising permanent, independent members.** These decision-making powers could either be allocated to an enlarged Board of Supervisors

(i.e., including additional permanent, independent members which would be tasked to represent the EU perspective) or to the newly set up body replacing the current Management Board. Under the lead of the ESA Chairperson, it would steer decision-making in an impartial and efficient manner.

These changes would reduce the propensity of inaction as regards non-regulatory decisions resulting from conflicts of interest faced by voting members. Such conflicts would be corrected by attributing to the permanent, independent members clear tasks and voting powers in certain decision areas. The design of the ESAs' governance would thus be improved, providing the decision-making bodies with better incentives to use their powers in the supervisory area and better enable them to address upcoming challenges.

The advantage of Option 2 is that it maintains the key elements of the governance structure which have proven to be functioning, while addressing in a targeted way the issues identified in the consultation and evaluation (highlighted in the problem definition). It will also ensure that the ESAs' governance structure allows the ESAs to fully play their role notably given upcoming challenges in the EU. The main disadvantage of Option 2 is that it arguably creates a more complicated governance model whereby the role of the various decision-making bodies varies according to the issue being discussed, and could lead to power games among these bodies.

In sum, targeted changes to the current governance set-up would address inherent incentive misalignments within the ESAs, hereby allowing them to better achieve their objective by using their powers and increasing their overall effectiveness. In addition, granting decision-making powers to the Chairperson and the permanent, independent Board members would allow for more efficient decision-making processes as it would free up time for swifter procedures and more discussion on policy and strategy within the Board of Supervisors. Decision-making processes would be allocated in a differentiated way, taking into account the nature of the decision to be taken and attributing them in a more efficient way (i.e., regulatory tasks would remain with the Board of Supervisors hereby recognising the need for taking into account the expertise of national CAs while supervisory decisions which need swifter and a more independent decision-making would be allocated to a newly created independent body as proposed in sub-options below).

### **7.4.3 Fundamental rebalancing of decision-making powers within the ESAs**

Option 3. Fundamental rebalancing of decision-making powers within the ESAs
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Option 3 proposes a more fundamental change to the overall governance and functioning of the ESAs. It would go further than Option 2 by transferring full decision-making powers to a newly set-up body of independent members at the centre of the ESAs. The Boards of Supervisors, composed of national CA would have a primarily advisory role.

In practice, the current Management Board would be replaced by a newly set-up body of independent members (as in Option 2). Voting powers on all decisions would be transferred



from the current Board of Supervisors to this body. As a result, the inherent conflicts of interest would disappear, as ultimate decision-makers would no longer have double mandates. In addition, the role of the ESA Chairpersons, as members of the independent body, would be strengthened (in line with Option 2). Accountability mechanisms would be enhanced accordingly.

The advantage of this Option is that it would remove the misalignment of incentives that characterise the baseline scenario, as it would minimise decision-makers' potential conflicting interests, as they would not have other mandates besides their ESA mandate. It would give rise to a clearer governance model with a straightforward allocation of tasks. Knowledge of national markets would still be maintained through the advisory role of national CAs within the Boards of Supervisors.

This Option also has a number of disadvantages. As the public consultation and the evaluation have shown, the problems related to the ESAs governance predominantly affect non-regulatory tasks and that there was no support for a fundamental overhaul of the ESAs. A full transfer of voting rights on all ESA powers, and regulatory tasks in particular, for which the ultimate competence lies with the Commission, would also affect decision-making in areas that function well and may therefore seem disproportionate with respect to the problem characterising the ESAs' current governance structure. In addition, the desired rebalancing between an EU perspective and national perspectives, respectively, would be excessive, if national CAs voting powers were fully transferred. The contribution of market knowledge and expertise by national CAs would be at risk of being lost.

Overall, compared to the baseline, the third option would increase the effectiveness of the ESAs in a context where the overall mandate and tasks of the ESAs are fundamentally changed towards more centralised powers. In case the current mandates and powers of the ESAs remain broadly unchanged, this option would imply a disproportionate overhaul compared to the issues identified.

## 7.5 Comparing the options

This section examines the effectiveness of the identified options in achieving the objective that has been set in section 7.3. The options will be compared with regard to the criteria of efficiency and coherence.

Objectives Policy option	<b>EFFECTIVENESS</b>	<b>EFFICIENCY</b> <b>(cost-effectiveness)</b>
1. No policy action	0	0
2. Targeted changes to the current	++	-

governance model		
3. Fundamental rebalancing of decision-making powers within the ESAs	+	-

*Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable*

Overall, changes under Options 2 and 3 should ensure that misalignments of incentives in the decision-making process are rectified. This would notably be achieved by allowing independent members to steer and participate in decision-making in an impartial and efficient manner. These permanent, independent members would have an exclusive ESA mandate and, as a result, would not face conflicts of interests between their ESA mandate and their national mandate. Overall, these 2 Options would increase the costs of running the ESAs if a new independent body (substituting the current Management Board) and, possibly, some support structures could not be staffed with existing ESA Senior Managers and staff.

The main difference between Options 2 and 3 concerns the allocation of decision-making powers within the ESAs alongside these two Options. In Option 2, changes to decision-making processes would be targeted to the areas which have been seen as progressing the least since the establishment of the ESAs (i.e., regulatory and supervisory convergence) and would leave unchanged the decision-making for regulatory tasks. This set-up would contribute to overcome inaction biases that are inherent to certain decision areas under the baseline scenario (e.g., breach of Union law decisions), and hence constitute a strengthening of the ESA governance's effectiveness. The simultaneous strengthening of the appointment procedure of the Chairperson would corroborate this. The changes should enhance efficiency in the functioning of the ESAs and notably increase efficiency in the Board of Supervisors' meetings, as a delegation of powers would free up time for the Board of Supervisors to have more efficient discussions.

Option 3 would imply a more fundamental shift in decision-making processes whereby all decision-making powers which are currently in the hands of the Board of Supervisors would be transferred to a decision-making body composed of independent members with an exclusive ESA mandate (replacing the current Management Board). However, the absence of national CAs as voting members in the decision-making structure would reduce national perspectives and expertise, which would hold back effectiveness. A transfer of all ESA decisions under Option 3 would therefore seem disproportionate with respect to the problems identified.

**Based on the advantages and disadvantages outlined above, the preferred Option is to make targeted changes to the current governance model whereby there would be a differentiated allocation of decision-making within the ESAs by type of decision (Option**

2). Compared to the baseline, Option 2 should significantly raise the effectiveness of the ESA's decision-making bodies, notably by strengthening the role of independent members with an exclusive ESA mandate, while preserving an important role for national CA representatives, thus making it more proportionate than Option 3. The preferred Option would involve additional personnel expenditure costs (which are analysed more in details in the following section) but appears attractive in terms of cost effectiveness.

## 7.6 Detailing and assessing the preferred policy option (sub-options)

Under the preferred (high-level) Option (Option 2 - Targeted changes to the current governance model) a number of issues require further clarification. The main features of this Option are: (i) structural enhancements of ESA decision-making bodies and the Chairperson; and (ii) the allocation of decision-making powers in relation to certain non-regulatory tasks to a decision-making body comprising permanent, independent members. As regards the second issue it notably remains to be clarified how such a decision-making body would look like and how it would relate to the structural governance enhancements resulting from the first point.

In the following, various sub-options are proposed as regards the two main features of the preferred Option 2 and compared to a scenario where there would be no changes to this component of the governance structure. The proposed sub-options can be cumulative, in the sense that the choice regarding the attribution of decision-making powers can be accompanied by various structural changes to the ESA governance. Where appropriate, differentiations between the ESAs are highlighted.

### 7.6.1 Enhancing the role of the Management Board including the Chairperson

Policy Sub-option	Description
1. No policy action	No changes to the Management Board composition or tasks.
2. Set-up of Executive Board with ESA Senior Managers as board members	The current Management Board would be replaced by an Executive Board composed of Senior Managers of the ESAs. Executive Board members would participate in the Board of Supervisors (national CAs representation may be envisaged).
3. Set-up of Executive Board with independent full-time board members	The current Management Board to be replaced by an Executive Board composed of independent full-time board members. Executive Board members would participate in the Board of Supervisors (national CAs representation may be envisaged).
4. Enhancing the standing of the Chairpersons	Granting voting powers and tasks to the Chairpersons (e.g., on supervisory convergence)

	and enforcement). Changes to the appointment procedure could also strengthen the Chairperson's input legitimacy and authority, and reduce of the possibility of capture by the Board of Supervisors.
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Sub-options 2 and 3 are alternatives whereas sub-option 4 can be combined with either one of them. As these complementary sub-options relate to changes to the current Management Board (note, the Chairperson is a member of the Management Board) they are presented jointly. At the current juncture, decision-making is in the hands of national CAs (on the Board of Supervisors) and the formal roles of the Chairpersons and Management Board are limited. This has resulted in misalignment of incentives within the ESAs. Changes to the Management Board, including the role of the Chairperson, that would turn it into an independent body that could steer decision-making in an impartial and efficient manner, would correct these misalignments. Statute, powers and tasks of this independent body and the Chairperson would require further clarification.

**Sub-options 2 and 3 would consist in a transformation of the Management Board into an Executive Board. Permanent, independent members would replace national CAs in the current Management Board (who are effectively a subset of the Board of Supervisors).** The Executive Board would be chaired by the Chairperson of the ESA. Such a transformation would be accompanied by an empowerment of the new Executive Board relative to the current Management Board, by giving it additional tasks and involving it in decision-making. The Executive Board members would notably have decision-making powers on certain non-regulatory issues, either via participation on the Board of Supervisors or directly as a result of a transfer of powers to the Executive Board (see above).

The number of Board members would not necessarily have to correspond to the current number of Management Board members (e.g., five besides the Chairperson) and may vary by ESA. It would be commensurate to the respective size and responsibilities of the relevant ESA, also taking into account supervisory responsibilities not attributed by through the ESA regulations. The current role of the Executive Director could be assumed by a member of the Executive Board.

**Sub-option 2 proposes appointing the Senior Managers (e.g., Directors, Heads of Department) of the ESAs as Executive Board Members.** This would ensure a close link between the Executive Board and the operational role of the ESAs. This Sub-option corresponds to the set-up of the SRB. The disadvantage of this Sub-option is that it may be difficult for Board members to fulfil both their managerial and operational tasks as Senior Managers and their strategic tasks as Board Members. This may result in a lacking reporting line between staff of the ESAs and the Board. In addition, there is a risk that silo effects emerge following the attribution of portfolios to the different Board Members. This Sub-option may have some marginal cost implications, notably if it implies an upgrade in the positions of Senior Managers.

**Under Sub-option 3, the Executive Board would be composed of independent full-time members, preserving an exclusive operational role for ESA Senior Managers.** This model corresponds to that of the ECB Executive Board, whereby the responsibilities of Board members are separate from those of senior management. The advantage of this Sub-option is that it clarifies responsibilities between executive and strategic tasks, and avoids the development of a silo mentality. While the number of Executive Board members would be relatively limited, this solution would have cost implications, as these additional positions, together with possible associated support structures, would need to be financed.

Provided that the Executive Board members would also become actual decision-makers, Sub-options 2 and 3 would warrant changes to the appointment procedure of the (future) Executive Board members, as increased responsibility should come hand in hand with increased accountability. While Management Board members are currently appointed by and from the Board of Supervisors, Executive Board members with decision-making powers should be appointed externally along a similar process as that envisaged for the Chairperson (see Sub-option 4 below), to ensure sufficient independence. This would hold regardless of whether Executive Board members are appointed in a full-time position or carry out tasks as senior managers of the ESAs (see Sub-option 2).

The main advantages of introducing permanent, independent members under Sub-options 2 and 3 is that it would enhance the decision-making process and in particular level out the perception that national interest sometimes unduly influence decision-making and policy action or lead to inaction. These members would have an exclusive ESA mandate and should hence never find themselves in a position where they may have to arbitrate between their national and supranational mandates.

In addition to decision-making powers on certain non-regulatory tasks, the Executive Board could be given tasks related to direct supervision (e.g., in the case of ESMA this would concern existing decisions on CRAs, TRs and new directly supervised entities). Such tasks could for example include the preparation of decisions. This possibility has received some degree of support in the public consultation. It would have the advantage of freeing up time for swifter procedures and more policy/strategic discussions within the Board of Supervisors.

The higher costs arising under Sub-option 2 and Sub-option 3 in particular, relative to the baseline, are to some extent offset by lower costs for convening the Executive Board, which would be located within the relevant ESA. Furthermore, the proposed changes aim to unlock the ESAs decision-making potential in certain areas which should ensure faster supervisory convergence, i.e., benefits that would justify slightly higher organisational costs. It should also be emphasised that the organisational models proposed are applied in other EU institutions (the ECB has an organisational model akin to Sub-option 3) or agencies (the SRB has an organisational model for Sub-option 2) dealing with financial issues.

In the non-financial area, there exist EU agencies with potentially less costly set-ups, which are more akin to the current Management Board of the ESAs; for example, the European Environment Agency has a decision making body ("Management Board") consisting of representatives of its member countries (broadly comparable to the ESA Board of

Supervisors) and a Bureau, composed of six national representatives, one Commission representative and one member designated by the European Parliament (broadly comparable to the ESA Management Board). The Body of European Regulators for Electronic Communications has a Board of Regulators (broadly comparable to the ESA Board of Supervisors), a Management Committee (broadly comparable to the ESA Management Board) composed of one member per Member State and the Commission and an Administrative Manager heading the BEREC office.

While these organisational models are arguably less costly than the ones proposed, they are characterised by a similar structure to the one that has been considered problematic for the ESAs under the current framework. Using them as a model for the ESAs would hence not solve the identified problems. They were therefore discarded.

**Sub-option 4 proposes to enhance the standing of the Chairpersons by attributing them voting rights and changing their appointment procedure.** The Chairperson is the key representative of the ESA. In that sense, the Chairperson's statutory authority is crucial for the ability of the ESAs to achieve their mandate. Enhancing the powers and status of the Chairpersons would ensure that his/her standing and influence is maximised. The attribution of voting rights on all or some of the decisions would enhance the Chairperson's authority and contribute to balancing out the effect of national perspectives in the decision making process. In line with this, the tasks of the Chairperson with regard to convergence and enforcement would also be increased in line with those of the Executive Board, making the ESAs more effective.

Changes to appointment procedure would raise the Chairperson's input legitimacy and authority. The current appointment by the Board of Supervisors may constrain the Chairperson's inherent authority, even though the appointment is confirmed by Parliament. This selection process may appear non-transparent and render the appointment of someone with new or diverging views more difficult, while reinforcing "club thinking" behaviour. While overall, the Chairpersons are considered to have executed their tasks well, concerns have been shared by stakeholders that their appointment procedure and their formal allocation of tasks do not provide formally them with the necessary authority or decision-making power which would enable them to intervene to better prioritize work and an EU orientation in the decision making processes. An external appointment procedure would strengthen the Chairperson's input legitimacy and independence and would ultimately strengthen the effectiveness of the ESAs.

## 7.6.2 Assessing proposed changes to the Management Board including the Chairperson

Both Sub-options 2 and 3 would set up an independent body with permanent members. Under Sub-option 2, the Management Board would be replaced by an Executive Board composed of the Senior Managers of the Agency. This Sub-option would guarantee an EU rather than a national perspective on the Board and correct the current incentive misalignments. This Sub-option may involve some additional costs, linked to the higher responsibilities of the Senior Managers. On the downside the direct association between a Senior Manager/Board member and a particular operational unit, may create the risk of a "silo"-perspective.

Under Sub-option 3, the Executive Board would be composed of full-time members, while the Senior Managers of the ESAs would retain their current function, with a particular operational responsibility. Full-time independent Board members should have both a central and a holistic view of the Agency's work. This would remove the incentive misalignments existing within the current Management Board and strengthen the Agency's core. This Sub-option would have stronger cost implications than Sub-option 2, as new positions (with the administrative support structure that is necessary) would need to be set-up.

Sub-option 4 would enhance the authority of the Chairperson and corroborate other changes made to the Boards. The Chairperson is responsible for the leadership of the Boards and should be pivotal in creating the conditions for the ESAs to attain their objectives and rendering them more effective.

**Overall, the favoured Sub-option would be a combination of Sub-option 3 and 4.** However, a differentiation by ESA may be warranted. The case for an Executive Board (i.e. **Options 2 and 3**) in view of making the ESAs more effective and correcting for incentive misalignments is strong overall. While Sub-option 3 would be more efficient and should be superior to Sub-option 2 from the point of view of effectiveness, the implied additional cost of a full-time Executive Board should be justified by the workload, size and responsibilities of the individual ESA. The implementation of the preferred Sub-option will imply some additional costs for the running of the ESAs. Assuming an average Executive Board size of 5 members (which may differ across ESAs), one of which would assume the role of the current Executive Director, already accounted for, the salaries and overhead expenses of the additional 4 full-time senior employees would need to be financed by ESAs annual budgets. Considering the large population of entities that will be indirectly supervised (more than 20,000 for ESMA, 10,000 for EBA and 4,000 for EIOPA), this additional cost is considered relatively minor.

**Table 7-1. Comparison of policy Sub-options against effectiveness and efficiency criteria**

Objectives Policy Sub-option	<b>EFFECTIVENESS</b>	<b>EFFICIENCY</b> <b>(cost-effectiveness)</b>
1. No policy action	0	0
2. Set-up of Executive Board with ESA Senior Managers as board members	+	-
3. Set-up of Executive Board with independent full-time board members	++	--
4. Enhancing the standing of the Chairpersons (role, powers and appointment procedure)	++	0

*Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable*

### **7.6.3 Allocation of decision-making powers on certain non-regulatory issues**

Policy Sub-option	Description
1. No policy action	The composition and voting structure remains as currently with national CAs maintaining all voting rights on non-regulatory issues in the Board of Supervisors.
2. Decision-making powers on certain non-regulatory issues attributed to Board of Supervisors comprising independent members	This Sub-option would add independent members to the Board of Supervisors who would be given voting rights for non-regulatory issues only.
3. Decision-making powers on certain	This Sub-option would transfer decision-making



non-regulatory issues attributed to a newly set-up independent body (Executive Board)	powers on non-regulatory issues from Board of Supervisors to a newly set-up independent body (Executive Board).
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**Decisions on non-regulatory issues (other than direct supervision) are particularly likely to be affected by the current decision-making structure.** This is because decision-makers on the Board of Supervisors have two mandates – the national CA and the ESA - and may find themselves in a position where they may have to arbitrate between national and European interests. Thereby it does not matter whether the representative's own Member State/CA or another Member State/CA is concerned, given the "repeated game" nature of decision-making (i.e., a national representative is unlikely to support action against a peer, if the latter can "retaliate" at a later stage). This is likely to result in an inaction bias that would likely persist absent any change (Sub-option 1).

Involving independent decision-makers (see Sub-option 2 and 3) would ensure that the conflicts of interest at the root of the inaction bias would be attenuated. These decision-makers would have a single mandate and could hence take an exclusive EU perspective when deciding. Appointing independent decision-makers on a permanent basis would also ensure more continuity and a longer-term perspective in the ESAs decision-making process, compared to the relatively high turnover on the Boards of Supervisors and Management Boards.

**Sub-option 2 would add permanent, independent members to the Board of Supervisors who would be given voting rights for non-regulatory issues only.** Regulatory issues would continue to be decided on by the Board of Supervisors, using QMV, and with national CAs having exclusive voting rights. Independent members would participate as non-voting members on these issues. This setting would have the advantage of strengthening the EU orientation of decision-making by adding the voice of independent members to the deliberations and better align incentives within the ESAs' decision making bodies. This Sub-option would also address the evaluation's finding that misaligned incentives predominantly affect the non-regulatory decision areas. The drawback of this Sub-option is that the independent members (under the assumption that their number would be limited) could still be outvoted by national CAs.

This Sub-option would be in line with the setting in other EU agencies and institutions where it is customary to have both "core" members and national representatives. The ECB provides such an example, where the six independent members (including President and Vice President) of its Executive Board are also voting members of the ECB Governing Council. The SRB provides another such example, as it is made up of a board of six independent members (including Chair and Vice Chair) and the Member States' national resolution authorities.

**Under Sub-option 3, decision-making on non-regulatory issues would be attributed exclusively to the Executive Board.** This Sub-option would essentially transfer decision-

making powers on non-regulatory issues from Board of Supervisors to the newly set-up Executive Board (as proposed above). This would ensure an exclusive EU orientation of decision-making and would eliminate conflicts of interest arising from double mandates. This Sub-option would rebalance the incentives in the decision-making process and steer decision-making in an impartial and efficient manner. Such a reallocation of powers to the Executive Board, may however require some form of accountability to and involvement by the Board of Supervisors.

The disadvantage of this Sub-option would be that the expertise of national CAs may be forgone in Executive Board decisions. Furthermore, it would represent a departure from the setting in other EU agencies and institutions where it is customary to have both "core" members and national representatives.

#### **7.6.4 Assessing the proposed changes to the allocation of decision-making powers on certain non-regulatory issues**

As outlined above, only Sub-option 2 and 3 both address the issues identified in the analysis, albeit with a different intensity. Sub-option 2 partly addresses the problem of misalignment of incentives in the area where it has proven to be more problematic, i.e., non-regulatory issues. Sub-option 3 corrects the problem of misalignment of incentives in a more authoritative way and hence appears to be the preferred way forward. Both Sub-option 2 and 3 could be combined with the transformation of the Management Board into an Executive Board with independent members (see following section).

**Sub-option 2 would constitute a targeted adjustment of the Board of Supervisors to address the problem identified.** Overall, changing the composition and voting structure within the Board of Supervisors would yield a more balanced decision-making process within the ESAs and ensure their ability to take decisions and apply the powers at their disposal (effectiveness). The coherence of the ESAs' governance would also be improved given that the decision-making structure of the ESAs would be better aligned with their EU mandate. Sub-option 2 is targeted in that it partly offsets the national perspective, where the consultation and evaluation have proven that it is most crucial, i.e., regarding non-regulatory issues (rather than proposing voting powers on all decisions).

**Sub-option 3 would constitute an effective and targeted way to fully eliminate the causes for possible inaction biases on the Board of Supervisors.** In particular, transferring non-regulatory decisions to an independent body would eliminate conflicts of interest that characterise national CAs and better ensure that the ESAs would effectively take decisions and apply the powers at their disposal. In particular, it would eliminate scenarios where a national CA could participate in decisions addressed to itself. Unlike Sub-option 2, it would rule out the possibility of the independent members being outvoted by national CAs.

Both Sub-option 2 and 3 would require independent decision-makers, which are not foreseen in the ESA Regulations. This would necessarily imply higher costs. It should however be pointed out that the costs of Sub-option 2 and 3 are similar as they are both based on the

premise of an independent body. That said the cost of holding dedicated meetings of a (small) Executive Board already located in a given ESA would likely be lower than convening meetings of the Board of Supervisors. Independently of these considerations, the cost issue is dealt with elsewhere (given the conditionality on the Sub-option retained, the cost-effectiveness is not further discussed in this section (see n.a. in comparisons table)).

*Table 7-2. Comparison of policy Sub-options against effectiveness and efficiency criteria*

<b>POLICY OPTIONS</b>	<b>OBJECTIVES</b>	
	<b>EFFECTIVENESS</b>	<b>EFFICIENCY</b> <b>(cost-effectiveness)</b>
1. No policy action	0	0
2. Decision-making powers on certain non-regulatory issues attributed to Board of Supervisors comprising independent members	+	<i>n.a.</i>
3. Decision-making powers on certain non-regulatory issues attributed exclusively to newly set-up independent body	++	<i>n.a.</i>

*Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable*

## **8 Funding**

Any extension in the scope of ESA powers will have implications for their governance (as discussed in the previous section) but also for their funding arrangements, to the extent that those extended powers require an overall increase in resources. The preferred Option for the extension of the ESAs' powers implies both an expansion in existing activities and the addition of new activities, inevitably there would be a corresponding increase in resource requirements (even allowing for some reallocation of existing resources).

It is important to note however that an increase in new activities in relation to direct supervision would be financed via fees charged to the industry, which reflect the full cost of services provided to the supervised entities. This is already the case for CRAs and TRSs, which ESMA charges fees to cover the costs of implementing and supervising their respective regulations. Fees from direct supervision cannot subsidise other ESAs activities. To this end, insufficient resources to cover existing ESAs needs (as discussed in the following section) cannot be covered by fees generated by new direct powers given to the ESAs.

This section will discuss in detail the implications of additional resources needs stemming from an expansion in activities, other than direct supervision, on the ESAs funding arrangements as well as the fitness and adequacy of the ESAs current funding structure to support new and existing business are discussed in detail in this section.

### **8.1 State of play**

#### **8.1.1 Funding basis and fees collection**

The ESA Regulations stipulate that the ESAs shall be funded by (a) obligatory contributions from the national CA, by (b) a subsidy (contribution) from the EU and by (c) any fees paid to the ESAs in the cases specified in the relevant instruments of EU law such as fees from direct supervision<sup>53</sup>. Revenues and expenditures of the ESAs are required to be in balance on an annual basis, any surpluses cannot not be carried forward to the next year and any deficit should be addressed within the financial year by adjusting expenditure. Out of these three available sources of financing, the core source is public (EU/national CAs) funding, while ESMA receives some private funding in respect of their limited responsibility for direct supervision.

In 2016, the ESAs total budget was EUR 95.6 million, from which approximately EUR 33 million came from the EU budget and EUR 52 million from the national CAs of the 28 Member States (Table 8.1). As indicated in the Evaluation (Annex 11.5), the ESAs' total budget has more than doubled during the first years of their establishment (2011-2014) with an average growth rate of more than 25% per year. This increase has reflected the fact that the ESAs were preparing to begin their operations and ensured a smooth transition from their

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<sup>53</sup> Article 62 of the ESA Regulations.

previous status as Committees of Supervisors. Thereafter, growth in their budgets growth has moderated indicating that they have entered a more mature stage of development.

**Table 8.1:** ESAs funding 2016 (in million EUR)

	Total budget	EU contribution	National contribution	CAs Income from direct supervision
<b>EBA</b>	<b>37.1</b>	14.7	22.4	0.0
<b>ESMA</b>	<b>36.9</b>	10.2	16.2	10.5
<b>EIOPA</b>	<b>21.6</b>	8.3	13.3	0.0

Note: ESMA's income from direct supervision corresponds to fees from CRAs and TRs

The ESA Regulations stipulate that when the ESAs are granted direct supervisory powers, the cost for this activity is levied entirely on the supervised entities under its remit. ESMA is the only ESA that has been granted direct supervisory powers to date. Since 2012, ESMA has been directly supervising CRAs and TRs. In this regard all costs from implementing the CRA and TR regulations are fully financed via fees and levies directly charged to CRAs and TRs. In 2016, the cost of directly supervising CRAs and TRs amounted to EUR 10.5 million or 28% of ESMA's total funding.

Excluding any funding received for direct supervision, the ESAs' budget comprises a 60 percent contribution from the Member States and a 40 percent contribution from the EU Budget<sup>54</sup>. Member State contributions are proportionate to their share of votes under the Council QMV rule and not necessarily to the size of their respective financial sectors. Receiving funding from the EU budget means that the ESAs have to respect the EU financial management and control framework as set in the Commission's Framework Financial Regulation<sup>55</sup> ("FFR"), including rules on the establishment and approval of the budget as well as audit and control.

### 8.1.2 Establishment and approval of the budget

The ESAs use an activity-based budgeting approach for preparing their annual draft budgets. This ensures a strong link between their annual work programs and the estimation of resources needed for all work streams to achieve their respective objectives.

The ESAs annual budgets are established on the basis of instructions provided by the Budgetary Circular<sup>56</sup> and aligned with the provisions of the Commission's Communication on

<sup>54</sup> Recital 68 of ESA Regulations.

<sup>55</sup> Commission Delegated Regulation (EU) No 1271/2013

<sup>56</sup> Annual detailed instructions from DG BUDG to Directors-General and Heads of Service on preparation of draft budget requests

the guidelines for programming document for decentralised agencies as well as on the template for the Consolidated Annual Activity Report for decentralised agencies (based on article 32 of FFR).<sup>57</sup> A Single Programming Document<sup>58</sup> as well as a draft budget request are transmitted by the ESAs to the Commission for consolidation and adoption by the Commission. The draft budget is then transmitted by the Commission to the Parliament and to the Council (the Budgetary Authority), together with the draft EU Budget.

On the basis of the ESAs budgetary proposals, the Commission enters into the draft EU Budget the estimates it deems necessary in respect of the establishment plan and the amount of the subsidy to be charged to the EU Budget. The Budgetary Authority adopts the establishment plan for each of the ESAs and authorises the amount of the EU contribution.

The amount of the annual EU contribution to the ESAs is decided within the Multiannual Financial Framework ("MFF"), and more specifically in line with the Commission's Communication on the programming of human and financial resources for decentralised agencies 2014-2020<sup>59</sup>. The MFF lays down the maximum annual amounts ("ceilings") which the EU may spend in the main policy areas over a period of at least five years, whereas the Commission Communication sets out annual ceilings for the EU contribution and the precise figures for the establishment plan posts for each EU agency until 2020 (see details in Table 8.2). A key assumption of the MFF is that the ESAs will keep growing until 2018. Thereafter they are expected to have reached a cruising speed mode. This essentially means that ESAs can continue benefiting from additional posts and from increases in EU funding until 2018 but no additional posts and almost stable EU funding in real terms (inflation corrected) is planned thereafter. Clearly, this assumption is not consistent with the preferred Option for expanding ESA powers (Section 6) in response to further integration of financial markets within the EU and between the EU and the rest of the world.

The final step in the budgetary process is the adoption of ESAs budget by their Board of Supervisors. The adopted budget becomes final after the final adoption of the EU Budget. During this process, the Parliament, the Council and the Commission can make adjustments to ESAs annual draft budgets<sup>60</sup>.

### **8.1.3 Accountability and Audit**

Each ESA adopts its own financial rules after having consulted the Commission. Those rules (ESA Financial Regulation) are tightly aligned with the provisions of the FFR unless the

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<sup>57</sup> Communication from the Commission on the guidelines for programming document for decentralised agencies, COM(2014) 9641 of 16 December 2014.

<sup>58</sup> A document required by Framework Financial Regulation containing multiannual and annual programming of an agency, which has to be submitted annually to the Commission, the European Parliament and the Council

<sup>59</sup> Communication from the Commission to the European Parliament and the Council of 10 July 2013 on the programming of human and financial resources for decentralised agencies 2014-2020, COM(2013)519.

<sup>60</sup> Alignments in order to comply with the MFF requirements and the adopted General budget of the Union

specific operational needs for the functioning of the ESA require a derogation. Any divergence from the FFR requires prior approval by the Commission<sup>61</sup>.

To enhance the enforcement of these rules, the ESAs have established internal control procedures to oversee the budget execution through quarterly reports to their Management Boards on the progress of the execution of the budget. Since 2013, the ESAs have been using a system of performance indicators to monitor progress vis-a-vis their budget execution. In addition, the ESAs have internal control officers and, as is the practice for many other EU agencies, an internal audit of the ESAs is carried out by the Commission. The ESAs have also established external control procedures. Their accounts and the use of resources are audited on an annual basis by the European Court of Auditors ("ECA")<sup>62</sup>.

The ESAs transmit their final accounts<sup>63</sup>, accompanied by the opinion of the Management Board, to the Board of Supervisors, the Parliament, the Council, the Commission and the ECA. The annual budget cycle ends when the Parliament, following a recommendation from the Council, grants discharge to each ESA for the implementation of the budget.<sup>64</sup> ESAs funding decisions and the implementing measures resulting from them are also subject to the European Anti-Fraud Office (OLAF) powers.

The aforementioned checks and balances by various EU institutions during the establishment, approval and execution process of the ESAs budgets protect the ESAs funding providers from uncontrollable and unjustifiable funding requests while ensuring a sound budgetary execution on a continuous basis.

## **8.2 Problem Definition**

An adequate funding system is one that enables the ESAs to achieve their objectives and is sufficiently flexible to respond to the changing needs of the ESAs in meeting those objectives. An adequate funding system should also link fees and contributions to ESAs' activities in a proportionate way.

The evaluation has identified problems in the core funding system of the ESAs in relation to two dimensions: (a) sufficiency in the perspective of further integration of financial markets within the EU and between the EU and the rest of the world; and (b) proportionality in so far as funding contributions from different sources should be better aligned to the scale of activities carried out by the ESAs.

These problems do not emerge in the funding for areas where the ESAs (currently only ESMA) have direct supervisory responsibilities. In other words, direct supervision is financed

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<sup>61</sup> Art. 65 of ESA Regulations

<sup>62</sup> Art. 64 of ESA Regulations

<sup>63</sup> The final accounts comprise the ESA financial statements (consisting of the balance sheet and the statement of financial performance; the cash-flow statement; and the statement of changes in net assets) and the reports on implementation of the ESA budget.

<sup>64</sup> Art. 64 of ESA Regulations

by fees charged to the industry that reflect the cost of the service, with the flexibility to be adjusted to reflect changes in such costs in a proportionate way across the supervised entities. This is therefore not part of the scope of the problem related to funding that this impact assessment is addressing.

## 8.2.1 Sufficiency

The tasks already entrusted to the ESAs as well as future tasks envisaged in on-going legislative work require an adequate level of staff and budget to allow for high-quality supervision. Sufficiency has both a static and dynamic dimension. In effect, the ESA budget must be adequate to the current tasks and mandates, prescribed by existing legislation, but it also needs to have the flexibility to adapt to the increased role for ESAs that can be expected as financial-market integration proceeds.

### 8.2.1.1 The static perspective

Over the past years, the Commission has proposed gradual increases of the annual draft budget and staffing levels for the ESAs, against the background of EU budgetary constraints, such as a 5% staff reduction target applicable to all EU institutions, agencies and bodies. The Parliament and the Council, in their role of budgetary authority, adopted the establishment plan for each of the ESAs and authorised the amount of EU contribution, to be charged to the General Budget of the European Union, on the basis of the draft budget proposed by the Commission.

Since 2014, the Parliament's Committee on Economic and Monetary Affairs in its annual Opinions prepared for the Parliament's Committee on Budgetary Control on the ESAs budget execution have repeatedly stressed that the ESAs current financing arrangement is inadequate, inflexible and burdensome and that it constitutes a potential threat to the independence of the ESAs.<sup>65</sup> According to various opinions<sup>66</sup> and reports from the European Parliament, the Council and the ECA,<sup>67</sup> the ESAs funding levels are already insufficient. Industry stakeholders have also raised concerns that the ESAs funding arrangements may not be commensurate with their likely increased tasks and responsibilities. Views expressed in the 2017 public consultation support the view that ESAs are under resource constraints, which are likely to constrain their ability to carry out their tasks. A number of respondents agreed that

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<sup>65</sup> ECON 2014/2122(DEC) published 26.2.2015; 2014/2121(DEC) published 26.2.2015; ECON 2016/2186(DEC) published 1.3.2017;

<sup>66</sup> Annual Opinions of the Committee on Economic and Monetary Affairs (ECON) on the ESAs budget execution: ECON 2014/2122(DEC) published 26.2.2015; 2014/2121(DEC) published 26.2.2015; ECON 2016/2186(DEC) published 1.3.2017

<sup>67</sup> See stakeholder replies to the Commission's 2014 Review Report, the Parliament's 2013 Review Report of the ESFS, the IMF Country Report No 13/65 on the Financial Sector Assessment of the European Union – Issues in Transparency and Accountability; the Parliament's 2014 Resolution on the European System of Financial Supervision Review; the 2014 Council conclusions on the ESFS Review, the 2016 Parliament Resolution on the Stocktaking and challenges of the EU Financial Services Regulation, testimonies before national parliaments, and the ESAs during Parliamentary hearings.



the ESAs will need adequate and sustainable funding in order to meet ambitious targets and enhance their operations and it was argued that the level of funding for the ESAs should correspond closely to their responsibilities and entrusted tasks.

The lack of sufficient resources would have important implications for the ESAs work, preventing the ESAs from addressing their increasing workload and from delivering on all their objectives and tasks. Although the ESAs budget doubled in the first 3 years of their operations (see evaluation in annex 5), this initial budgetary growth reflected the need to accommodate the ESAs increasing workload to fulfil their mandate, i.e., to achieve a more integrated regulatory framework (the Single Rulebook). In effect, even this growth rate seemed insufficient, as in its 2014/05 report, the ECA stated that "*overall, EBA's resources during its start-up phase were insufficient to allow it to fulfil its mandate*".<sup>68</sup>

In addition, the ECA found that EBA has not been able to fulfil its consumer protection mandate due to, among other things, a lack of resources. Likewise, the ECA found that EBA had insufficient staff to conduct the 2011 stress tests. Furthermore, it has been argued that the Commission may have underestimated in its legislative proposals the investment costs for IT systems to be developed and maintained (e.g., for ESMA the Commission proposed EUR 0.5 million compared to EUR 8 million necessary according to ESMA). Further illustrating the ESAs' budget and resource constraints, one of the ESAs had to reduce and temporarily suspend their financial market monitoring activities. In addition, opinions expressed in the 2017 public consultation confirm that due to limited resources the ESAs could not make full use of the abundant financial market data they have at their disposal. The ESAs' inability to deliver on their objectives and tasks on time due to resource constraints has occasionally delayed the Commission's decision on delegated acts, as well as led to unwanted reprioritization of important policy initiatives/tasks.<sup>69</sup> In turn, this caused delays in implementation of both Level 2 and Level 1 legislation.<sup>70</sup>

### **8.2.1.2 The dynamic perspective**

The funding arrangements for the ESAs should be commensurate with their tasks. To this end, these arrangements should be flexible enough to adjust sustainably over time to cover any future additional tasks, resulting from further integration of financial markets within the EU. For instance, the additional workload for the ESAs linked to the objective of achieving greater regulatory and supervisory convergence, as announced by the CMU initiative in late 2015, is a clear example of an important project that was not known at the time when the Commission adopted its Communication on programming of human and financial resources for

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<sup>68</sup> 2014/05, Special Report European banking supervision taking shape — EBA and its changing context, p.8 point IV.

<sup>69</sup> For example in order to address budget constraints, ESMA deprioritised (removed) from its IT Work Programme 2017-2019 the development of the European Electronic Access Point (EEAP) in favour of the implementation of the Prospectus Directive and Money Market Funds Regulation projects.

<sup>70</sup> For example, EBA's advice on equivalence of third-country regimes and the technical standards on anti-money laundering

decentralized agencies 2014-2020. Moreover, the individual Member States' share in the ESAs budget could be expected to increase further once the United Kingdom leaves the EU.<sup>71</sup>

Evidence suggests that ESA funding is already stretched to the limit. Since their creation, the ESAs are subject to an increasing workload. As Table 8.2 illustrates, since 2010, the number of level 1 text which tasks foreseen for the ESAs has almost doubled for ESMA (From 12 level 1 texts in 2010 to 23 in 2017) and increased by 40% for EBA and EIOPA (from 5 to 7 level 1 texts). This increase in secondary law is also accompanied by an intensive use of more detailed and complex legislative measures which place more obligations on the ESAs. Moreover, the perimeter of banking, pensions, insurance and securities market regulation has considerably widened over time, surrounding a much broader set of market participants and activities, tackling new weaknesses of the financial system and thus conferring new powers and obligations to ESAs. In addition, the increasing inclusion of "third country regimes" in primary legislation (currently envisaged in 15 EU acts) also increases the ESAs workload, as the assessments of equivalence by the Commission are usually performed on the basis of technical advice from ESAs.

**Table 8.2**

<b>EU legislative acts within the scope of ESAs' remit<sup>72</sup></b>		
	<b>2010</b> (under Article 1(2) of their Founding Regulations)	<b>2017</b>
<b>ESMA</b>	<ul style="list-style-type: none"> <li>• 12 Level 1 texts</li> <li>• 13 Level 2 texts</li> </ul>	<ul style="list-style-type: none"> <li>• 23 Level 1 texts</li> <li>• 303 Level 2 texts out of which: <ul style="list-style-type: none"> <li>○ 174 adopted,</li> <li>○ 129 not yet adopted</li> </ul> </li> </ul>
<b>EBA</b>	<ul style="list-style-type: none"> <li>• 5 Level 1 texts</li> <li>• No Level 2 texts</li> </ul>	<ul style="list-style-type: none"> <li>• 7 Level 1 texts</li> <li>• 116 Level 2 texts out of which: <ul style="list-style-type: none"> <li>○ 84 adopted</li> <li>○ 32 not yet adopted</li> </ul> </li> </ul>
<b>EIOPA</b>	<ul style="list-style-type: none"> <li>• 5 Level 1 texts</li> <li>• No Level 2 texts</li> </ul>	<ul style="list-style-type: none"> <li>• 7 Level 1 texts</li> <li>• 56 Level 2 texts Out of which: <ul style="list-style-type: none"> <li>○ 33 adopted</li> <li>○ 23 not yet adopted</li> </ul> </li> </ul>

Source: European Commission

<sup>71</sup> While the ESAs will lose roughly 5% of their total budget (the result of 8.24% from QMV voting rule times 60% of the total budget provided by national CAs), with the departure of the United Kingdom, there is no clear evidence suggesting that the workload of the ESAs will reduce by a similar amount. In fact, the workload may actually increase, as the ESAs will have to deal with third country issues for several markets and entities that are operating from the United Kingdom and vice versa. Moreover, at least initially, the withdrawal of the United Kingdom from the EU and the resulting relocation of some businesses to the EU27 will increase the ESAs work on convergence including preventing regulatory arbitrage.

<sup>72</sup> See Annex 11.4.

Table 8.2 also illustrates that there has been an extensive use of Level 2 rules specifying the detailed application of the Level 1 acts. For example in the case of ESMA, there are currently 303 level 2 acts (out of which almost half are still to be prepared to be adopted), against only 13 level 2 texts in 2010. Similarly, there are 116 new level 2 texts for EBA (one third of which is pending preparation for adoption) and 56 new level 2 texts for EIOPA (almost half of which is pending preparation for adoption). Finally, ESAs will need to monitor and ensure the supervisory convergence of all the level 1 and level 2 measures under their remit.

The increasing constraints on public budgets both at EU and at Member State level and the increasing workload of the ESAs mean that the current funding arrangements may no longer be affordable over time. For example, a number of national CAs have raised the issue of increasing difficulties contributing to ESA budgets due to budgetary constraints<sup>73</sup>. Furthermore, stakeholders are concerned that further budgetary increases for ESAs risk translating into funding reductions for supervisory authorities at national level. A further complication results from the fact that the MFF has capped the EU annual contribution to the ESAs budget to a maximum annual lump sum, which in 2020 reaches approximately EUR 16 million for EBA, EUR 9.9 million for EIOPA and EUR 12.6 million for ESMA. Due to the fixed distribution of funding between the EU and the national CAs, the mentioned caps put a constraint on ESAs overall future budget. This means that ESAs cannot easily rely on additional resources. According to the establishment plan, which needs to be respected by each ESA, the annual maximum number of posts, is capped for the period 2018-2020 and no growth is envisaged after 2018 (Table 8.3).

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<sup>73</sup> For example, for many of the smaller regulators, the cost of an ESA is 20-30% of their budget.

**Table 8.3: EU programming of human and financial resources for decentralized agencies - overview 2014-2020**

Name of the decentralised agency	Budget line	Cruising speed years in period 2014-2020	Total EU contribution / authorised establishment plan								Total EU contribution 2014-2020
			2013	2014	2015	2016	2017	2018	2019	2020	
<b>European Banking Authority (EBA)</b> <i>Authorised establishment plan</i>	<b>12 03</b> (12 04 02)	2019-2020	10,387	11,304	12,021	13,104	14,115	15,123	15,683	15,997	97,349
<b>European Insurance and Occupational Pensions Authority (EIOPA)</b> <i>Authorised establishment plan</i>	<b>12 03</b> (12 04 03)	2019-2020	7,507	7,514	7,763	8,134	8,676	9,365	9,734	9,929	61,117
<b>European Securities and Markets Authority (ESMA)</b> <i>Authorised establishment plan</i>	<b>12 04</b> (12 04 04)	2019-2020	8,697	9,077	9,603	10,099	10,888	11,876	12,377	12,624	76,543
			121	128	133	138	150	163	163	163	

Source: COM(2013)519

Under the EU MFF 2014-2020, the ESAs' budgets were supposed to grow at 8% per year until 2018. Thereafter, the MFF assumed that the ESAs would reach the cruising speed, which implies that their growth rate would be lower than in the period of the phasing-in of tasks. At the same time, the EU is facing budget constraints and this trend is expected to continue or even intensify when the United Kingdom leaves the EU.<sup>74</sup> Therefore, it may be reasonable to assume that the next MFF may envisage fewer resources from the EU Budget for the ESAs.

Any discrepancy between the actual needs of the ESAs and the means available by the EU Budget makes the fixed distribution of the ESAs' funding between EU Budget and national CAs a "straight jacket", because it reduces the flexibility of the ESAs to adjust funding from sources other than the EU Budget and according to their needs (even if marginal). Under this

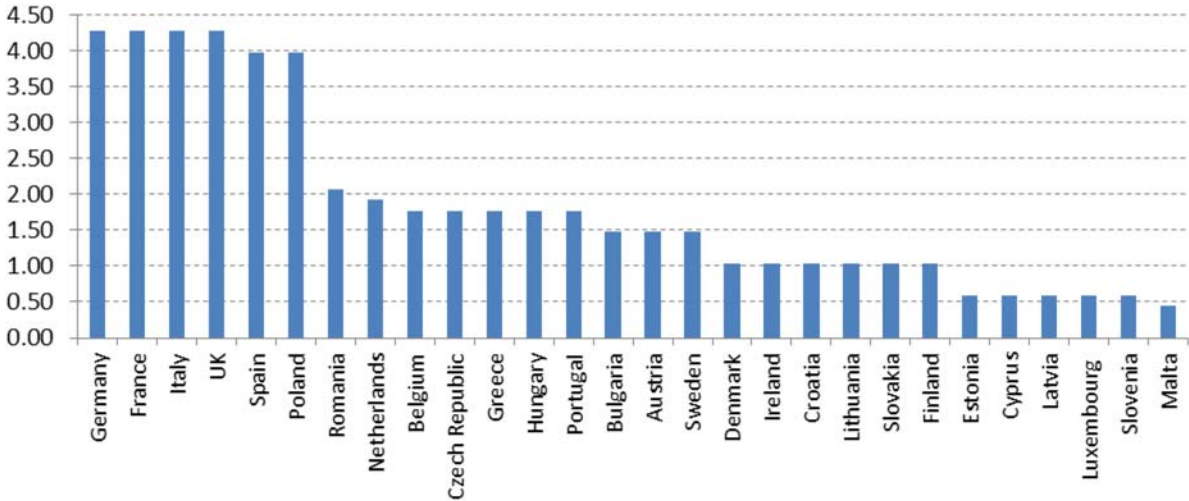
<sup>74</sup> See EU revenues Policy paper 183, 16 January 2017, p. 6, Jacques Delors Institute "Brexit and the EU budget: Threat or opportunity?"

restriction, any extra resources needed to cope with increased workload can only be achieved by reprioritising the current work programme, reallocating existing resources or simply not executing certain tasks. The feedback received in the 2017 public consultation shows awareness among stakeholders that ESAs need a sustainable source of funding in order to be able to accomplish their goals.

**8.2.2 Proportionality**

The use of the QMV weights to calculate the national CAs contributions to ESAs does not take account of the size of the national financial sectors across Member States. This is problematic given the diverse development of the financial sectors in the various Member States. The current system implies that national CAs from Member States with a large financial market contribute less relative to their size, while national CAs from Member States with small financial markets may be due to pay more in relation to their size. To illustrate this problem, we compare national CAs contributions to the ESAs budget in a given year to the size of their respective financial market for the same year. National CAs' contributions in a given Member State are summed up in order to reflect the total contribution to ESAs by Member State.

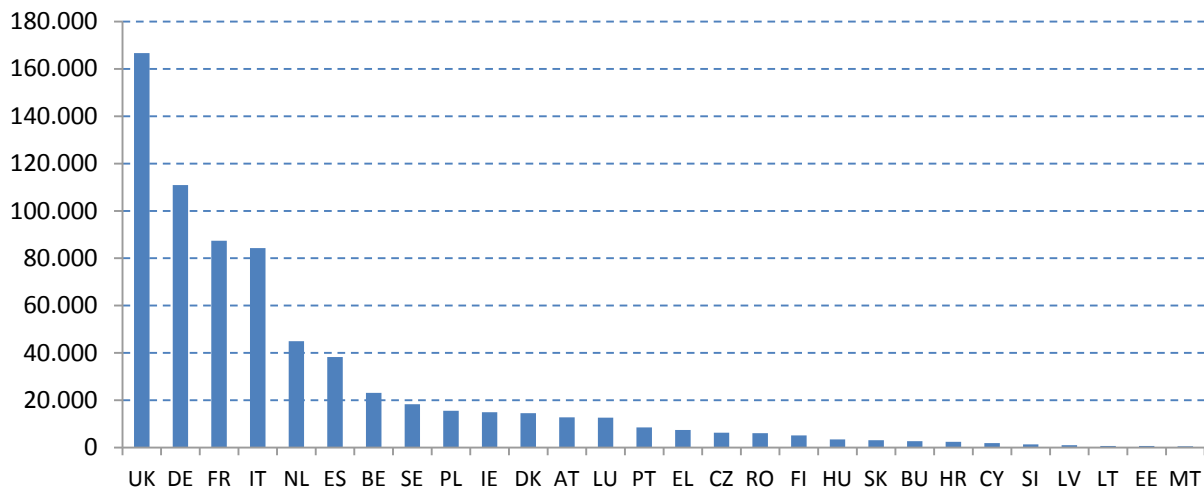
**Figure 8.4: Current national CAs' contribution according to Council voting rule (EUR million)**



**Source: ESAs annual reports and own calculations**

As shown in Figure 8.4, in 2016, national CAs' total contribution per Member State to the ESAs' budgets ranged approximately between EUR 0.5 and 4.2 million. Germany, France, Italy and the United Kingdom were the largest contributors to the ESAs budgets, with EUR 4.25 million each, followed closely by Spain and Poland. Conversely, Malta was the smallest contributor to the ESAs' budgets in 2016, paying EUR 440,000 in 2016, followed by Slovenia, Luxembourg, Latvia, Cyprus and Estonia that contributed approximately EUR 500,000 each to ESAs budget in 2016.

**Figure 8.5: Size of the financial sector, 2016 value added (EUR million)**



**Source: Eurostat.**

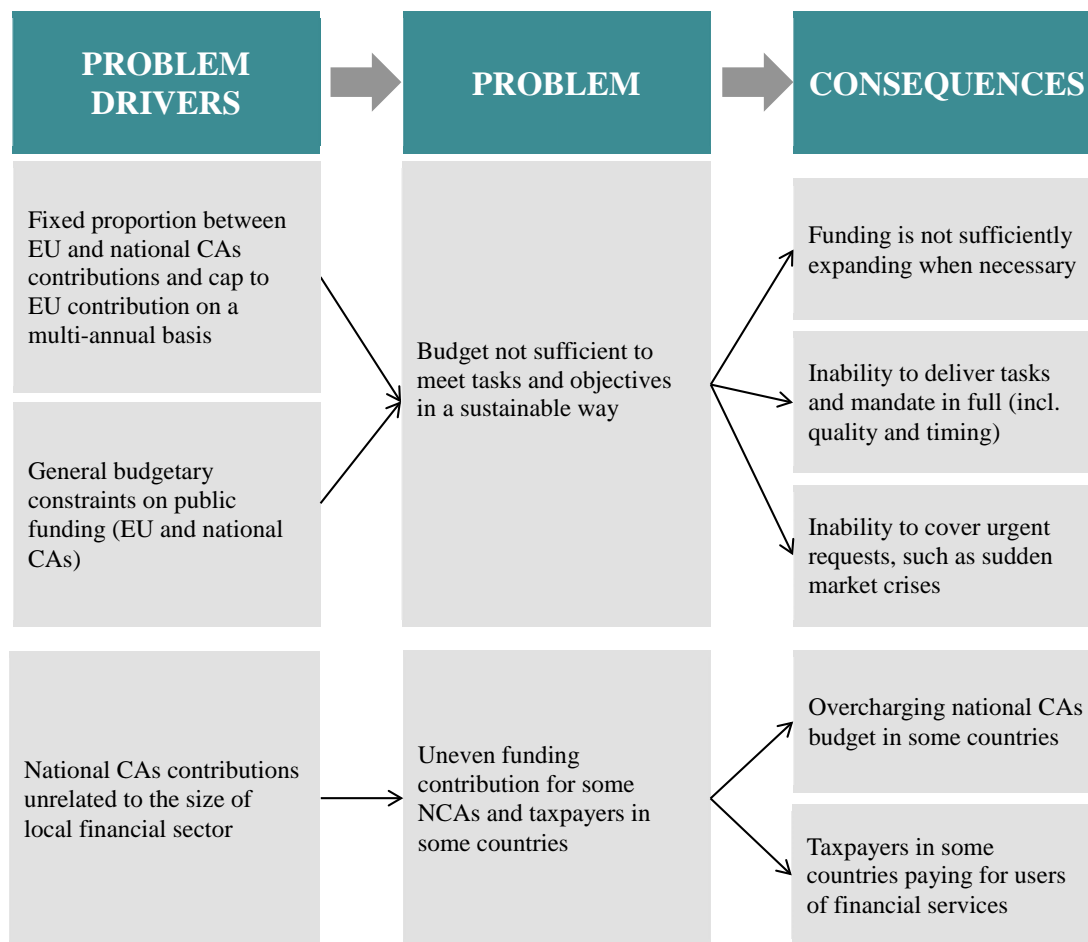
In contrast, Figure 8.5 shows that the United Kingdom had in 2016 the largest financial market, totalling approximately to 24% of the total EU market share. The United Kingdom, Germany France and Italy constitute together more than 64% of the total value added of the EU financial sector, but they only contribute roughly one third of the ESAs' budget. In addition, the United Kingdom's contribution to ESAs budget is close to that of France or Italy, which have financial sectors that are about a half of the size of the of the United Kingdom. Poland, belongs to the group of six largest Member States that are contributing to almost a half of the ESAs total annual budget (together with Germany, France, Italy, United Kingdom and Spain) but it has a financial sector substantially smaller than the other five contributors. The financial sector in the Netherlands is larger than the Spanish one but Spain contributes more to the ESAs budget. Notwithstanding the large size of its financial sector, Luxembourg's current contribution to the ESAs budget is the second lowest<sup>75</sup>, after Malta.

Important differences across EU Member States also exist as regards the funding models of national CAs. Some national CAs are fully funded by the industry, such as in Belgium, France, Germany, the Netherlands, whereas others are partially or fully funded by the public budget, such as in the Czech Republic, Cyprus, Ireland, Portugal. Furthermore, industry funded national CAs use different models and methodologies to charge fees to individual entities, which results in an uneven fee distribution among industry and taxpayers across the EU.

The Problem Tree below illustrates problems, drivers and consequences.

<sup>75</sup> Together with Slovenia, Latvia, Cyprus and Estonia

**Figure 2.4 Specific problem tree**



### 8.3 Objectives

The general objective behind a potential policy action is to ensure that the ESAs operate effectively and efficiently in carrying out their objectives and tasks as stated in ESA Regulations<sup>76</sup> and sectoral legislation. Achieving the general objective will also enable the ESAs to play a key role in the further integration of the EU financial markets and to promote the development of the CMU.

From the perspective of the ESAs' funding arrangements, these general objectives can be translated into the following specific objectives:

- ensuring that the ESAs' annual funding is sufficient to meet the mandates and tasks prescribed by EU legislation in a sustainable way (**S-1**);
- ensuring that the way that the ESAs are funded is proportionate to the costs that all contributing parties generate (**S-2**).

<sup>76</sup> Regulation (EU) No 1095/2010, [Insert ref to ESAs founding regulations]

**Table 8.3 Objectives**

Problems	Problem drivers	Specific objectives	
		S-1	S-2
ESAs budget: - is insufficient to meet the mandate and tasks provided by EU legislation in a sustainable way  - is not proportionate for some national CAs and their respective taxpayers in some countries	MFF caps the EU annual contribution to the ESAs budget on a multi-annual basis.	√	
	Budgetary constraints on public funding (EU and national CAs)	√	
	The current system for calculating contributions from national CA's does not reflect the size of domestic financial sectors		√

#### 8.4 Policy Options and Impact Analysis

This section discusses the details and the impact of three alternative policy options to address the problems identified in section 8.2. The three options are assessed against the baseline scenario, i.e., that the current funding framework remains in place. The first option consists in adjusting the existing public funding model. The second and third option entail a change to the three key features of the current funding model (outlined in section 8.4.1 below) by introducing different degrees of industry funding contribution.

**Table 8.4 Policy Options**

Policy options	Description
1. No policy action	The baseline scenario applies.
2. Adjusted public funding	The MFF in force continues to define the maximum EU contribution in a given year to ESAs budget (set in EUR million). This amount would serve to cover up to 40% of ESAs' annual funding needs. The residual funding needs would continue to be covered by contributions from national CAs but these contributions would now be a function of the size of the Member States' domestic financial sector.
3. Mixed funding	The same assumption for EU funding as in option 2 applies, but the residual funding needs of the



	ESAs would be met by private sector contributions based on the activities carried out by the ESAs replacing contributions from the national CAs.
4. Fully private funding	Public funding is fully replaced by private sector funding.

The following sections describe the options and their potential positive and negative impact in reaching the objectives as outlined in section 8.3.

#### 8.4.1 Baseline scenario

**Option 1 - No policy action** – The baseline scenario applies. No modifications to the key features of the current funding model.

There are **three key features** of the current funding model:

1. full public funding<sup>77</sup>;
2. fixed distribution of public funding between EU budget (40%) and national CAs budgets (60%);
3. allocation of national CAs' contribution according to Article 16(4) TFEU.

Under Option 1, all three key features of the funding structure remain in place. Most notably, the ESAs' budget would continue being financed from the EU Budget (40%) and from contributions from national CAs (60%) made in accordance with the QMV weighting set out in Article 16(4) TFEU.

The main advantage of this Option is its simplicity in calculation and collection. The Council voting distribution leaves no space for interpretations and legal disputes. In addition, weighting is fixed and thus the national CA's contribution to the ESAs annual budgets evolves in a predictable way over time. Another advantage is that the fee collection process for the ESAs is easy (low number of debit notes per year) and there would be no need for new investments in IT, collection systems or additional human resources. Accountability and audit mechanisms would also stay intact. However, keeping the current system means preserving existing inefficiencies and leaves many challenges unaddressed, as assessed in the problem definition section. For example:

- the ESAs would continue to have reduced flexibility to cope with existing and new challenges since their EU funding growth is capped by the MFF at least until 2020;
- under the current funding mechanism any funding increase for the ESAs may translate into a funding reduction for the national CAs (in particular for those national CAs that

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<sup>77</sup> With the exception of fees charged for directly supervised entities where applicable

are integrated supervisors contributing to two or three ESAs). A number of national CAs have signalled increasing difficulties linked to their contribution to ESA budgets due to budgetary constraints or national austerity measures;

- the proportionality of the current cost allocation among national CAs remains problematic, as it does not reflect the size of the domestic financial sectors, which ultimately determine the need for regulatory and supervisory action by the ESAs. This makes the allocation of contributions among national CAs uneven and potentially unfair, with taxpayers in some countries required to pay more than in others. It also makes the contribution disproportionate for small national CAs, which may become excessive relative to their annual budget;
- important changes are expected from both sectoral legislations and external factors, like the departure of the United Kingdom from the EU, which may exacerbate budgetary constraints and may require flexibility in the funding structure;

The situation produces a misalignment between national CAs, which cannot contribute more to ESAs budgets, and the ESAs, which want to be able to deal fully with their current workload and future challenges. At the same time, budgetary constraints at the level of the EU Budget need to be taken into account as well.

Based on the above argumentation, it seems that maintaining the baseline scenario is not effective in ensuring that the ESAs' annual funding is: (a) commensurate to the mandates and tasks given by EU legislation; and (b) sustainable for the years to come. Maintaining the status quo may also not be efficient since the way that ESAs are funded would continue to be uneven across Member States and across financial entities.

#### **8.4.2 Adjusted public funding**

**Option 2. Adjusted public funding** This Option modifies two of the three key features of the baseline scenario (the fixed funding distribution and the national CAs contributions' key). The MFF in force defines the maximum EU contribution in a given year to ESAs budget, as a fixed upper limit in EUR million. This amount would serve to cover up to 40% of ESAs' annual budget. The residual funding needs of the ESAs annual budget would be covered by contributions from the national CAs, with no longer a fixed distribution between EU and national CAs. Moreover, the current weights used to calculate contributions from the national CAs would be replaced by weights based on the size of the domestic financial sector.

Option 2 would replace the requirement under which ESAs should be financed in fixed proportions, i.e., 40% from the EU budget and 60% from the national CAs.<sup>78</sup> Currently, the amounts foreseen in the MFF for the ESAs funding during the period 2014-2020 determine

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<sup>78</sup> The Commission sets the threshold to the annual EU budget contribution to each ESA in its Communication to the European Parliament and the Council on programming of human and financial resources for decentralized agencies 2014-2020. According to this Communication, the annual EU budget contribution to ESAs budget is capped to a maximum annual lump sum, which in 2020 reaches 38.2 m. euros for the three ESAs.

the amounts provided by the national CAs during the same period, so *de facto* setting a cap on the total funding for the ESAs. Under the new arrangement, the 40% would instead be set as a maximum amount for the annual EU contribution to the ESAs' budget, while national CAs' would meet the residual funding needs,. In addition to introducing flexibility into the ESAs' budgets, the described change would better reflect the presence of the national CAs in the Board of Supervisors of ESAs, which determines the budget, and it would accommodate the adjustments needed in the short-term to fulfil the regulatory and supervisory objectives. It would also reflect the increasing role that the ESAs have in supporting national CAs to achieve supervisory convergence, in line with the subsidiarity principle.

Moreover, national CA contributions would be adjusted in accordance to the size of the financial markets in their respective Member States. To this end, Member States with relatively smaller and less developed financial sectors (like all or most Member States that joined the EU in 2004) would contribute to the ESAs budgets according to the actual size of their sector under the ESAs' remit. As suggested by the simulations in Annex 11.4.2, if Member State contributions are calculated using weights based on financial sectors' value added, this would result in a redistribution of funding among national CAs which is closer to the actual impact domestic financial sectors have on the activities of the ESAs.

An advantage of using financial sectors' value added as a proxy for the financial sector size is that the indicator is publicly available, regularly updated, and, most importantly, validated by Eurostat.<sup>79</sup> It relies on the "Statistical classification of economic activities in the European Community", abbreviated as NACE. The quality of the data is assured by strict application of the ESA 2010<sup>80</sup> concepts by Eurostat and by thorough validation of the data delivered by countries.<sup>81</sup> Given the above reasons, the size of a country's financial sector is often approximated by the valued added.<sup>82</sup>

Respondents to the 2017 public consultation believed that taking into consideration the size and the complexity of the financial industry relevant for financing ESAs would result in a fairer cost distribution across Member States. Some of those also mentioned that the weighting of Member States' votes in ESAs' Boards of Supervisors would need to be adjusted accordingly. Views were divided among stakeholders as to the exact metrics to be used in

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<sup>79</sup> Eurostat provides breakdowns of GDP aggregates by main industries and asset classes. In particular, it provides yearly data capturing gross value added and income for financial and insurance activities.

<sup>80</sup> The European System of National and Regional Accounts (ESA 2010) is the newest internationally compatible EU accounting framework for a systematic and detailed description of an economy.

<sup>81</sup> An alternative indicator to proxy the size of the financial sector could be the total assets of the legal entity operating in the financial sector, as reported in balance sheets. However, this indicator would have multiple flaws. First, it increases the risk of double-counting financial exposures, as highly intermediated financial markets mask double counting and requires major work to clean up numbers to take into account potential consolidation among firms. Second, this measure does not fairly represent the weight of entities that do not extensively use their balance sheet to operate in the financial sector, but produce a sizeable impact through their activities. This is the case for CCPs, asset managers (that operate with matched books) and other market operators (like trading venues or high-frequency trading firms). For those, other indicators would need to be developed, requiring new statistics sufficiently sound for a legal use.

<sup>82</sup> See for example: Mary Everett, Joe McNeill and Gillian Phelan, Measuring the Value Added of the Financial Sector in Ireland.

determining Member States' contributions. Some respondents opted for using as a proxy of the market size an aggregate of total assets, potentially risk-weighted. Others suggested using revenue, profit, or market capitalisation data.

An additional advantage of pursuing Option 2 is that the system could continue to rely on the current collection mechanism directly from national CAs, with no additional operational costs. Many respondents to the 2017 public consultation highlighted efficiency, legal simplicity, predictability and stability of fees collection as the main arguments in favour of Option 2.

However, Option 2 does not help solve the sustainability issue, i.e., whether budgetary growth rates of national CAs can support the ESAs' in the years to come. Although adjusted contributions for Member States with relatively smaller and less developed financial markets become smaller (see simulations in Annex 11.4.2), this Option will overall increase the relative size of national CAs contribution (as the EU Budget contribution is capped in the multi-annual framework). A related risk is that some national CAs may not be able to cope with the increase in their contributions in case this is required to address additional workload of the ESAs. This situation may also exacerbate when national CAs will have to fill ESAs financing gap from the UK leaving the EU (see Figure 2 of Annex 11.4.2). In addition, Option 2 may create a discrepancy between the voting (Council's QMV voting rule) and the contribution methodology (value added), which could put national CAs with larger financial sectors at a disadvantage compared to the baseline scenario.

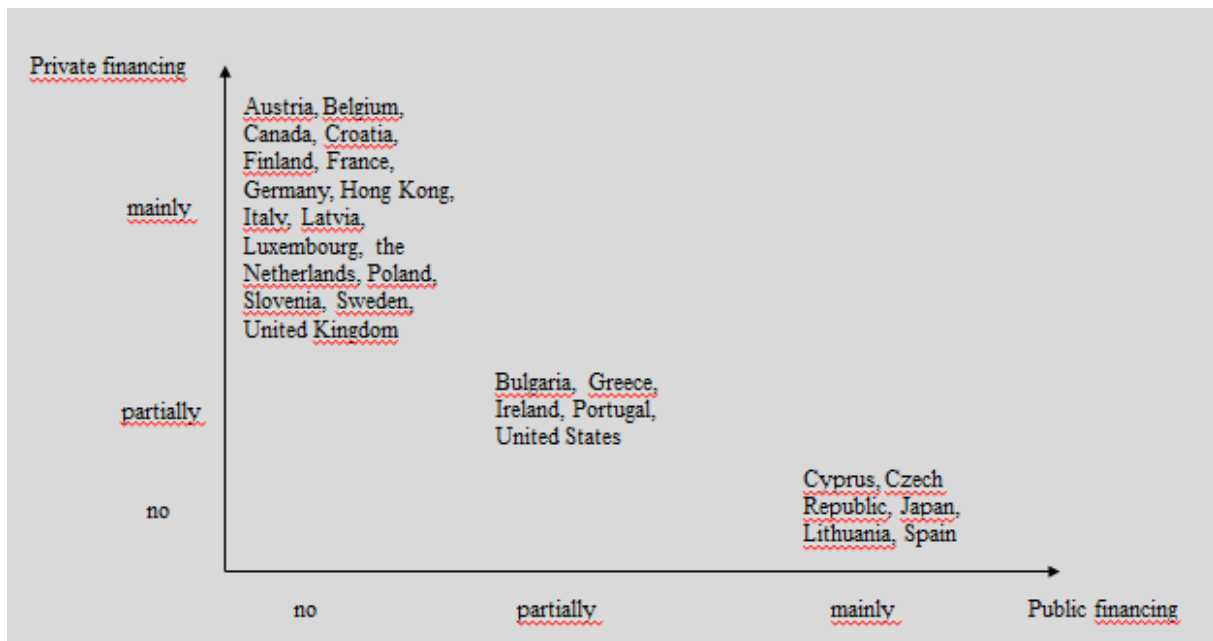
Finally, regarding the net impact to the industry, this will depend on the model used to finance national CAs within a Member State. For example, if national CAs are fully publicly funded Option 2 would magnify the proportionality problem, as it would increase the indirect taxpayers' subsidisation of services provided to the financial industry. On the other hand, if a national CA is fully industry funded then the resulting burden/relief would probably be transmitted to the supervised entities under the national CA's remit.

To conclude, notwithstanding the problems identified above, Option 2 is more effective than the baseline scenario in ensuring that ESAs annual funding remains commensurate with the mandates and tasks given by EU legislation (sufficiency); however Option 2 does not help solve the sustainability issue although it addresses it better than the baseline scenario. In terms of efficiency, the implementation of Option 2 does not seem to create extra costs to the ESAs since the fee collection process would remain the same.

### **8.4.3 Introducing private funding contribution**

In order to deal with the abovementioned sufficiency and proportionality problems, most of the supervisory authorities around the world have complemented or even replaced public funding of financial supervision with direct contributions from the private sector. Supervisory authorities in the United States, Hong Kong, United Kingdom and Canada, largely rely on funding raised from the private sector, more specifically from those entities or individuals that are directly or indirectly regulated and supervised by financial authorities.

**Figure 8.1. Funding of supervisory authorities in the EU<sup>83</sup> and selected overseas jurisdictions<sup>84</sup>**



**Source: own analysis, based on Mansciandaro et al. (2007).**

The key advantage of using private funding for supervisory authorities is that it increases the financial autonomy of the institution, which becomes less dependent on constrained public budgets and therefore can adjust their funding if necessary, subject to appropriate accountability mechanisms (e.g., review or authorisation by Commission, Council and Parliament). In this regard, the effectiveness of the governance, control and accountability mechanisms over the budget determination and execution process would be crucial to avoid the risk that the ESAs would use their new budget flexibility to unjustifiably, expand their activities and impose an unnecessary burden on the industry.. Conversely, in order to avoid any external interference with the independent work of the supervisory authority, it would be essential that the contributing private sector entities would not have any formal right to intervene in the decision-making process, on top of what is already granted via standard tools, like consultations or stakeholder groups.

The 2017 public consultation showed limited support for industry contributions across the population of respondents, which was dominated by private organisations and companies. The majority of respondents opposed ESAs funding by the industry mainly because they feared a potential negative impact on ESAs accountability to EU institutions and a potential duplication of payments for the industry thus creating new burdens for them. Moreover, respondents had a potential difficulty to indicate a common and appropriate basis for the determination of private sector contributions. Some respondents argued that ESAs work is a

<sup>83</sup> The list of countries is not exhaustive.

<sup>84</sup> The category of partial public/private funding may result from a situation where some financial sectors (e.g. capital markets) are supervised by privately funded authorities while other sectors (e.g. banks) are supervised by publicly financed institutions including Central Banks.

public good for which the public should pay. It seems that respondent reactions could be linked to a lack of clarity in the public consultation on how the new financial arrangements would be organised. These issues are elaborated in detail in the present impact assessment. Some respondents to the 2017 public consultation recognized that clear and harmonised rulesets produced by ESAs benefit the financial industry in particular as they reduce regulatory compliance costs. Moreover, respondents pointed to the fact that private funding of supervisory authorities was a practice common in many Member States and that private funding would enhance ESAs budgetary flexibility.

As explained in Section 5 the legal basis of setting up the ESAs (Article 114 TFEU) allows amending the funding regime and collecting contributions from the industry.

The following sections discuss two options involving private funding: a mixed private funding system and a fully private funding system.

#### 8.4.3.1 A "mixed" solution

**Option 3. Mixed public-private funding** – This option modifies one key feature of the baseline (full public funding), it replaces a second one (national CAs' contributions) and removes a third key feature of the baseline scenario (fixed distribution between EU and national CAs' contributions). First, it complements the public funding currently provided by the EU with private sector funding. Second, it uses the contributions from domestic private sectors to replace contributions from the national CAs. Third, the maximum EU annual contribution, as set in advance in the MFF, would cover up to 40% of ESAs' annual budget with the remaining part covered by the private sector.

This Option involves three main changes to the key features of the current funding system (baseline). It removes the fixed distribution (40/60) between EU and national CAs' funding. The removal of the fixed distribution (also foreseen in Option 2) prevents that multi-annual constraints on the EU Budget spill over onto other forms of funding. While preserving the accountability and auditing over ESAs' annual budgets by other EU institutions (e.g. European Commission and European Parliament),<sup>85</sup> it introduces more flexibility to deal with new ESAs' tasks and/or supervisory powers, ultimately linked to the objective of enhancing regulatory and supervisory convergence (as envisaged for the development of the CMU).

This Option replaces funding from the national CAs with private sector funding, to reflect the fact that the regulatory and supervisory activities of the ESAs are linked to financial sector activities. The replacement of national CAs funding with direct contribution from the private sector would have three main advantages. First, it would avoid duplications of fee collection from national CAs that are already collecting fees from the industry and it would avoid the need to harmonise methodologies used by national CAs for fee allocation across the EU to limit this duplication. Second, it would increase the funding independence and flexibility of the ESAs by creating a funding system that is not directly or indirectly influenced by 28

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<sup>85</sup> For more details, please see section 8.1.3.

different national budgetary constraints, as growth rates of national budgets may not increase as fast as growth rates of ESAs' activities, including upcoming challenges.<sup>86</sup> Therefore, the ESAs would be able to perform tasks to achieve their key objectives without producing a direct impact on budgets of national CAs. Third, it would introduce a uniform fee setting mechanism among financial entities, rather than less accurate aggregate country estimations of domestic financial sectors (as for Option 2).

Preserving EU financing implies involvement of Parliament and Council as Budgetary Authority and discharge authority,<sup>87</sup> as well as the application of the FFR, which ensures the transparency of the ESAs' internal financial procedures and supports their accountability and that the ESAs' budget grows in line with the resources needed to achieve their objectives. Under Option 3, the ESAs would remain subject to oversight by the established EU framework for financial audit and control mechanisms, which would also help to protect the ESAs from any kind of fraud and would enhance the ESA's efficiency. The experience with existing EU agencies shows that EU financing guarantees the stability of revenues. Moreover, by maintaining EU contributions Option 3 prevents excessive reliance on private sector's contributions, which could entail the risk of budgetary problems in case one or several entities for whatever reason would fail to contribute.

The implementation of Option 3 also requires a methodology to allocate the contributions to the private sector (a) and a collection mechanism (b).

The allocation of contributions across sectors (a) could be based on a so-called "activity-based key", which relates the amount of contributions to be paid for the activities carried out by the ESAs to financial sectors under their supervisory remit. The key advantage of using an activity-based key is the compliance with the full-cost recovery principle.<sup>88</sup> The ESAs could implement this allocation methodology relatively easily, since their annual work programs already state analytical objectives and the costs required delivering them. In particular, ESMA already uses a similar methodology to determine fees levied on credit rating agencies and trade repositories. ESMA has also developed an accounting system that is able to attribute every authority's task to the regulated financial sector that ultimately benefits from it.

Once contributions are allocated across sectors, contributions per entity should be calculated and charged in a proportionate and transparent way, under the principle of equal treatment. To this extent, the appropriate distributional key per sector should be identified following additional analysis in secondary legislation. A size indicator for each cluster of firm may be a simple and transparent distribution mechanism, which would also ensure a proportionate allocation of ESAs' costs on market participants corresponding to each participant's level of activity within a given regulated sector. Moreover, size indicators ensure equal treatment, as

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<sup>86</sup> For instance, the additional activities (such as greater policing of equivalence arrangements, other third country regimes, etc) and greater concentration of public funding that will derive from the departure of the United Kingdom from the European Union.

<sup>87</sup> As discussed more into detail in section 8.1.3.

<sup>88</sup> Full cost recovery means that the fees charged to the industry are reflecting the cost of services provided by ESAs to this industry.

the measure is established for each entity in the sector, thus allowing for differentiating contributions in the required proportionate manner. As a result, this allocation mechanism would meet multiple objectives at the same time. Illustrations on how the allocation methodology could work in practice are presented in Annex 11.4.3.a preliminary set of indicators that could be considered for allocating fees to the entities within a given sector. In the economic literature, the size of an entity within a given sector is often assessed through well-known indicators. For example, the size of a credit institution is usually captured by the value of its total assets;<sup>89</sup> the size of an investment management company is captured by the value of its assets under management;<sup>90</sup> the size of an insurance undertaking is usually given by the value of its gross written premiums<sup>91</sup> and so on. A number of national CAs are also using such indicators (i.e. total assets for credit institutions, assets under management for investment firms etc.) for allocating fees to entities under their remit.

As for the collection mechanism (b), the ESAs would need an additional power vis-à-vis the baseline, i.e. the ability to request data from national CAs or directly from entities under ESAs' remit, which would be required to contribute financially to ESAs' budget. In addition, tapping funding from the private sector is likely to require additional resources (and thus extra cost vis-à-vis the baseline), whether contributions are collected by the ESAs themselves or via national CAs on behalf of the ESAs.<sup>92</sup> As discussed extensively in section 8.4.3.3, depending on whether the collection mechanism is directly managed by the ESAs or via national CAs, these costs (per ESA) would range between EUR 1,000,000 and EUR 3,000,000 one-off costs and between EUR 600,000 and EUR 1,400,000 recurring costs (yearly). The indirect collection mechanism via national CAs might in the end provide the 'least cost' and most effective tool for fee/contribution collection.

Based on the existing experience with other partially industry funded EU decentralised agencies,<sup>93</sup> the fee/contribution allocation and collection modalities may be set either entirely in the founding regulation of the agency or further details would be established in a separate delegated act. While both options are legally feasible, there seems to be more advantages to leave details in a separate delegated act to be adopted by the Commission. This would leave the principles of the budget establishment, implementation, monitoring, accountability and collection system in the ESAs Regulation. All the technical modalities on the fees allocation and collection would be tackled in a delegated act. This would avoid charging the ESAs Regulation with excessive details on the fees/contributions determination, while respecting general principles, including legal clarity.

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<sup>89</sup> See for example: (a) Dirk Schoenmaker; Dewi Werkhoven; 2012; What is the Appropriate Size of the Banking System? DSF Policy Paper Series, Policy Paper No. 28; (b) ECB's Banking structures Report (October 2014).

<sup>90</sup> See for example: Global Financial Stability Report: Navigating monetary policy challenges and managing risks, International Monetary Fund, April 2015.

<sup>91</sup> See for example: EIOPA, Financial Stability Report, December 2016

<sup>92</sup> See discussion in Section 8.4.3.3.

<sup>93</sup> See for instance the European Medicine Agency, the European Chemical Agency and the European Aviation Safety Agency.



### 8.4.3.2 A fully private funding system

**Option 4. Fully private funding** – It removes all three key features of the baseline by replacing public funding contribution with a funding system fully financed by the private sector.

The main advantage of this Option is that full funding from the industry would not entail any additional expense from the EU Budget and can be adapted autonomously by the ESAs. In addition, using private sector funding to finance supervision draws funding sources from those subject to financial supervision (and whose activity requires such supervision) rather than from taxpayers. At the same time, any fees, taxes or charges imposed on financial institutions may affect/distort their functioning and operational models.<sup>94</sup> Moreover, a significant layer of complexity would be lifted if the ESAs budget was not subject to the adoption procedures of the EU Budget.<sup>95</sup>

On the other hand, full industry funding would as a consequence mean that the control by EU institutions and the accountability requirements vis-à-vis the Budgetary Authority would be significantly weaker than if there is EU funding involved. This could be perceived as reduced control and increased risk. This was specifically raised as a concern among stakeholders responding to the 2017 ESA public consultation. Another common argument raised in favour of fully private financing is the need to ensure independence of the ESA from excessive influence of both Member States and the European institutions. However, experience with existing EU agencies and the ESAs suggests that they enjoy an appropriate degree of autonomy to be set out in the ESA Regulations.

Private funding is usually perceived as a pro-cyclical funding source for financial supervision<sup>96</sup>. This could be particularly problematic in times of financial crises when financial supervision is especially needed but supervised entities do not have the necessary financial means to support it. In addition excluding EU financing completely to rely on private funding would entail the risk of budgetary problems in case of several private entities for whatever reason fail to contribute. Finally, risks that need to be managed when using private funding are potential conflicts of interest arising between the supervisor and supervised entities. Economic theory points out that an implicit contract may exist between the financial industry, as a vested interest group, or between individual financial institutions and the supervisor.<sup>97</sup> This implicit contract could serve the specific interests of the regulated firms, for example by softer regulatory requirements, special accounting rules, and forbearance in general.

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<sup>94</sup> Alan Deardorff. "Distortion", Deardorff's Glossary of International Economics.

<sup>95</sup> Articles 36-52 of Regulation (EU, Euratom) No 966/2012 (Financial Regulation)

<sup>96</sup> In business cycle theory and finance, any economic quantity that is positively correlated with the overall state of the economy is said to be pro-cyclical. That is, any quantity that tends to increase in expansion and tend to decrease in recession (e.g. during financial crises) is classified as pro-cyclical

<sup>97</sup> G. J. Stigler (1971). The Theory of Economic Regulation, Bell Journal of Economics and Management Science, 6(2), pp. 114-141.

For the implementation of this Option, the same elements as in Option 3 would apply, with regards to funding allocation to entities and fee-collection mechanisms (see Annex 11.4.3 and Section 8.4.3.3).

Regarding the net impact to the stakeholders, under Options 3 and 4, the allocation methodology would replace contributions from national CAs for industry funding under ESAs remit. In this regard, the net impact to national CAs should be neutral as on the one hand national CAs would stop contributing to ESAs funding and on the other hand they should reduce (in a proportionate way) their needs for revenues to cover this expenditure.

Under these Options, the net impact to the market participants would depend on the model national CAs currently use to finance themselves. For example, if market participants in a given Member State do not currently pay for their supervision (i.e., as the case of fully publicly funded national CAs) then, by definition, the allocation methodology under Options 3 and 4 would result in increased cost for these market participants at the benefit of taxpayers and national budgets in those Member States.

However, if market participants already pay for the ESAs via contributions to their national CAs' budgets then the net impact (incremental cost/benefit) of the allocation methodology under Options 3 and 4 would depend on the various methodologies that national CAs use to charge fees to individual entities as well as the weights they apply to entities for ESAs funding, if any. To this extent, in order to come up with a reliable estimate of the incremental cost/benefit across the EU, a thorough comparative analysis is needed. This would require the involvement of those national CAs applying own methodologies on fees allocation in order to provide the Commission with their respective baselines for conducting the comparative assessment.

In any case though, it could be reasonably argued that establishing a level playing field across the Single market with a uniform fee setting mechanism among financial entities would ultimately benefit all market participants. In addition, it should be noted that the amounts required to fund ESAs (even in the extreme case of fully funding by the industry) should not, in principle, pose a threat to individual entities' operational models (see simulations in Annex 11.4.3).

### **8.4.3.3 Collection Mechanism**

The following section discusses the potential costs involved with the creation of a collection mechanism to enforce the mixed or fully privately funded solution.

EBA and EIOPA currently receive contributions only from the EU (40% of their budget) and national CAs (60%). ESMA, instead, receives contributions from the EU, national CAs and from directly supervised entities, i.e. Credit Rating Agencies (CRAs) and Trade Repositories (TRs). Costs related to the collection of funds from the EU, national CAs and the private sector (in the case of ESMA's directly supervised entities) is today rather limited (see first

column in the table below).<sup>98</sup> The costs related to collecting the contributions from national CAs can be estimated at around EUR 45,000<sup>99</sup> per year per ESA. In the case of ESMA, an additional EUR 45,000<sup>100</sup> is foreseen for the fee collection and invoicing of directly supervised entities (for a total of EUR 90,000).

**Table 8.5 Costs of current collection mechanism**

	<b>EIOPA</b>	<b>EBA</b>	<b>ESMA</b>
<b>Contributions</b>	EU, national CAs	EU, national CAs	EU, national CAs, plus TRs and CRAs' fees
<b>Number of FTEs<sup>101</sup></b>	0.4	0.4	0.8
<b>Estimation of IT costs</b>	EUR 5,000	EUR 5,000	EUR 10,000

*Source: ESAs*

A funding model based on mixed (private-public) or fully private financing, as in the case of Options 3 & 4 respectively, requires a review on how fees and contributions are currently collected. In particular, it needs to be determined how industry fees/contributions will be collected, safe-kept and transferred to the ESAs. Notably, the collection mechanism will require to: (i) ask information from market participants and financial institutions and verify them; (ii) calculate the contribution/fee; (iii) prepare the invoice to be sent; and (iv) collect the annual contributions from the entities.

Two options for collection mechanism could be envisaged:

- a. A collection of contributions/fees via the national CAs (or public authority appointed by the Member State); or
- b. A collection of fees by the ESAs directly from entities.

Under option (a), the delegation of the collection of fees from ESAs to national CAs would generate some new costs for ESAs, estimated around EUR 1,000,000 one-off costs and EUR 600,000 recurring costs per ESA. These costs would relate mainly to IT and human resources. In terms of IT resources, these costs are estimated at EUR 200,000<sup>102</sup> per year and roughly

<sup>98</sup> Those costs include mainly IT and human resources. As regards IT resources, for the collection of contributions from the EU and national CAs, the ESAs send so-called recovery orders to national CAs, whose number depends on the number of national CAs and the number of instalments per year. The annual maintenance cost of the needed IT infrastructure are estimated at around EUR 100,000 per year. As regards human resources, the number of FTEs needed oscillate around 0.5, needed mainly for the management of the budget and accounts.

<sup>99</sup> Approximately 0.5 FTE a year (~ 40,000 EUR) + indirect IT costs (EUR 5,000).

<sup>100</sup> Approximately 0.5 FTE a year (~ 40,000 EUR) + indirect IT costs (EUR 5,000).

<sup>101</sup> Stands for full-time equivalent, which is the number of hours worked by one employee on a full-time basis. The concept is used to convert the hours worked by several part-time employees into the hours worked by full-time employees.

<sup>102</sup> Estimations by EIOPA.

EUR 1,000,000 of upfront IT costs. As to human resources, additional resources (5 FTEs per ESA) are expected to be required given a more complex budget planning process, the calculation and verification of the amounts to be received, as well as budget monitoring and additional reporting.

On the one hand, the delegation of fee/contribution collection from the ESAs to national CAs would avoid duplication with national collection mechanisms and would rely on the systems and enforcement mechanisms used by most of the competent authorities. The costs of such a system would be more easily internalised by national CAs' accounting and finance departments, due to their current knowledge of the market and infrastructure. The system would be also easier to understand and more accessible for market participants, as they would deal with one public institution.<sup>103</sup> On the other hand, some national CAs are fully funded by public budgets, so they would need to set up a system for the determination and collection of the fee/contribution (as above), which may delay the implementation process. In addition, this collection mechanism may complicate the information to be processed by national CAs that already tap private funding, as they would need to keep two separate systems to distinguish between the two payments. Finally, there might be differences in values to be reconciled between the total aggregate amount per national CAs expected by the ESAs (according to entity-level data to be previously provided by the national CAs) and the actual amount transferred by the national CA.

**Table 8.6 Setting-up costs for a collection mechanism (cost per ESA)**

	<b>Status quo (current situation)</b>	<b>Indirect collection of industry contributions via national CAs</b>	<b>Direct collection of industry contributions</b>
<b>Number of FTEs</b>	0.4	5	Up to 15
<b>IT costs (one off)</b>	-	EUR 1,000,000	Up to EUR 3,000,000
<b>IT costs (recurring)</b>	EUR 5,000	EUR 200,000	EUR 200,000

Under the alternative option (b), i.e. a direct collection mechanism managed directly by the ESAs, total costs (per ESA) may range between EUR 1,000,000 and EUR 3,000,000 (one-off) and between EUR 680,000 and EUR 1,400,000 (recurring), as summarised in the table above. Given the substantial number of entities falling under their remit (i.e. 20,000 entities for ESMA, 10,000 for EBA, 4,240 for EIOPA), the collection of fees would require a much higher amount of IT and human resources, compared to what is needed today or in the alternative option. A new IT system would be needed to process invoices sent to the entities,

<sup>103</sup> In the 2017 public consultation, many respondents favoured a fee/contribution collection by national CAs due to its legal simplicity, greater efficiency and predictability. There were views among respondents that ESAs fees should be deductible from contributions to national CA and that it was key to ensure that the 'basis' for fee calculation covers all financial institutions present in the jurisdiction concerned.

which may require an initial investment estimated between EUR 1 and 3 million<sup>104</sup>, as well as ongoing maintenance costs of EUR 200,000 a year.<sup>105</sup> This option will also have an impact in terms of FTEs, due to the planning, monitoring and management of the budget, as well as handling of complaints and other. The exact number of additional resources is difficult to estimate, but a comparison with other EU agencies that levy fees on the industry suggests that 6 to 12 FTEs could be necessary.<sup>106</sup> Based on the assumption that around 5,000 entities would be invoiced, EBA estimates the number of required additional resources at 9 to 15 FTEs.

On the impact of such option, on the one hand, the direct collection mechanism by the ESAs would ensure full independence from national CAs and their ability to collect fees from the private sector, as well as limit the legal and operational risks of diverging estimation or required coordination with national CAs invoicing systems. Cross-border entities would also benefit from one single interaction with the ESAs, instead of multiple interactions with national CAs. There may be also synergies with the information system for the direct collection mechanism already established for directly supervised entities (in the case of ESMA). Moreover, Member States that finance their national CAs through government budget would not be obliged to put in place a system of collection from the industry. On the other hand, there are multiple challenges with this option. There might be operational risks, as the ability of the ESAs to invoice a large number of market participants (more than 20,000 entities for ESMA, 10,000 for EBA, and 4,000 for EIOPA) has not been tested yet. The direct collection mechanism would also require additional IT staff and facilities, thus increasing ESAs costs, and potentially creating redundancies with national CAs already collecting contributions from the industry (including the enforcement mechanism). The system would be also potentially more complex, as market participants would receive invoices both from the ESAs and from the national CAs.

**Table 8.7 Benefits and drawbacks**

<b>Indirect collection</b>		<b>Direct collection</b>	
<b>Benefits</b>	<b>Drawbacks</b>	<b>Benefits</b>	<b>Drawbacks</b>
<ul style="list-style-type: none"> <li>- 'Least cost' solution</li> <li>- Easy to implement and understand</li> </ul>	<ul style="list-style-type: none"> <li>- Set-up costs for national CAs</li> <li>- Coordination risk with national CAs</li> </ul>	<ul style="list-style-type: none"> <li>- Full funding independence</li> <li>- Beneficial for cross-border entities</li> </ul>	<ul style="list-style-type: none"> <li>- High cost</li> <li>- Operational risks</li> <li>- Duplications with national CAs collection</li> </ul>

While both options for fee/contribution collection determine an increased in costs vis-à-vis the baseline scenario, the costs incurred with option (a) are cumulatively lower than option

<sup>104</sup> EIOPA estimates this initial investment at EUR 1 million at least. ESMA considers that this initial investment should be in the range of EUR 2-3 million at least.

<sup>105</sup> Estimations by EIOPA

<sup>106</sup> Estimations by ESMA.

(b). As a result, at least until the ESAs would have not sufficiently developed their infrastructure and expertise at entity level, option (a) would be more cost effective and efficient to implement the preferred funding option (mixed funding). Also stakeholders, including Member States, have expressed support for this option.

## 8.5 Comparing the Options

This section examines the effectiveness of the identified options in achieving the set objectives. We are looking in particular at the specific objectives which have been set in section 8.3. The options will also be compared with regard to the criteria of efficiency and coherence, according to the following definitions:

- effectiveness: The extent to which options achieve the objectives of the proposal with sufficient legal certainty;
- efficiency: The extent to which objectives can be achieved for a given level of resources/at least cost (cost-effectiveness);
- coherence: The extent to which options are coherent with the overarching objectives of EU policy.

**Table 8.8 Comparison of policy options against effectiveness and efficiency criteria**

Objectives Policy option	EFFECTIVENESS		EFFICIENCY (cost-effectiveness)
	Sufficiency Sustainability (Objective S-1)	& Proportionality (Objective S-2)	
<b>Option 1:</b> "No policy change"	0	0	0
<b>Option 2:</b> "Adjusted Public Funding"	+	+	0
<b>Option 3:</b> "Mixed Funding"	++	++	0
<b>Option 4:</b> "Full Private Funding"	+	++	–

*Magnitude of impact as compared with the baseline scenario (the baseline or no net impact is indicated as 0): ++ strongly positive; + positive; – – strongly negative; – negative; n.a. not applicable.*

For what concerns effectiveness, Option 3 is the preferred option. Option 3 is preferable to Option 1 (baseline) and Option 2 as it better achieves a sufficient, sustainable and proportionate funding.

In terms of **sufficiency (and sustainability)**, in its static and dynamic perspective, Option 3 provides more funding sufficiency going forward for several reasons. First, it combines public funding (EU budget) with private funding contributions, so offering a certain degree of diversification to reduce risk of constraints on public budgets spilling over onto ESAs' activities and vice versa. Second, Option 3 also offers additional protection against the impact of the potential departure of the United Kingdom from the European Union. According to the simulation in Annex 11.4.2, a reduction equivalent to the contribution attributed to the United Kingdom, combined with the more proportionate allocation among national CAs suggested in Option 2, would determine an increase in contribution for top 5 countries by financial sector (Germany, France, Luxembourg, Netherlands and Italy) between roughly 100% and 150% of current contribution. This increase materialises in an environment of budget cuts or limited growth even for national CAs fully funded by the private sector. Third, with the removal of the fixed proportion between EU and national CAs' funding, national CAs' contribution could be a potentially sizeable contribution compared to the contribution from the EU budget, somehow conflicting with a key objective of the review, i.e. to increase the independence and self-standing capabilities of the ESAs. If one particular source of funding were to be overly dominant (as in the case of Option 2 and 4), the implications for the functioning or independence of the ESAs' governance may undermine their efforts to safeguard financial stability and protect investors.

In terms of proportionality, Option 3 is preferable to Option 2 as it draws funding contributions from those whose activity requires supervisory or regulatory actions by the ESAs and not from taxpayers. In addition, Option 3 also strengthens, in comparison to Options 1 and 2, convergence at a European dimension by ensuring an even contribution for financial sectors across the EU, as they will be subject to one calculation methodology (potentially to become a reference point also for national collection systems). Option 3 is equally efficient to Option 1 (baseline) and Option 2 in terms of accountability and audit mechanisms to which the budgetary processes are subject, as they will remain equally in place under these different options, ensuring high efficiency and transparency. This would not be the case for Option 4, which with less public scrutiny, could provide less incentives to reach similar efficiency level in the use of private sector resources. Option 3 is also preferable to Option 4, as full private funding may create an insufficient level of budgetary control and accountability at EU level and may not be able to provide sufficient counter-cyclical buffer, if a major systemic event occurs. In terms of **efficiency (cost effectiveness)**, it should be noted that the objectives set out by the review cannot be achieved at zero cost and the net costs (net of savings) cannot be fully determined. Therefore, implementing Option 3 operationally is more costly than Option 1 (baseline) and Option 2 in terms of human resources needed for the calculation and invoicing of fees to private entities. Under the chosen collection mechanism (via national CAs), the actual cost (per ESA), provided in Section 8.4.3.3, may be around EUR 1,000,000 for IT systems (one-off), plus EUR 600,000 of recurring costs (including 5 FTEs). Option 2, instead may run recurring costs just slightly higher than the baseline (roughly EUR 45,000 recurring costs per ESA) to ensure that the national CAs' contribution is regularly reviewed and enforced. Yet, despite Option 3 determines higher direct costs for setting up the system, it is still considered to be equally cost effective (efficient) than Option



2, as it delivers more objectives than Option 2 with a solution that is marginally more expensive and certainly cheaper than Option 4. Moreover, the operational costs might be partially offset over time by the synergies that a common collection methodology would create by spilling over onto national collection systems.

In terms of **coherence**, Option 3 (mixed funding) is coherent with EU objectives to deepen financial integration, as announced in key European policies, like CMU. Option 3 is also coherent with the appropriations planned in the 2014-2020 MFF.

As a result of the above mentioned assessment of the impact on sufficiency (and sustainability), efficiency and coherence, Option 3 (mixed funding), with an indirect collection mechanism (via national CAs) and separate charging for supervisory fees on directly supervised entities, is the preferred option.

## 9 Cumulative impact of the chosen options

This section reviews the cumulative impact of preferred options identified for the powers, governance and funding of the ESAs, against the general baseline scenario as discussed in section 4.2. No policy action means that the ESAs will not be able to fully perform in their role to foster convergence of supervision, which can be exploited by national CAs and private sector. These negative implications of the baseline scenario are further accentuated by the consequences of the decision of the United Kingdom to leave the EU. A specific concern in this context results from the relocation of market participants currently established in the United Kingdom to establish a presence in the EU to ensure they will be able to continue to provide services also after the United Kingdom has left the EU.<sup>107</sup> As such market participants request authorisation for potentially significant operations in the EU, it is important that their choices of places of establishment are not guided by possibilities of regulatory and supervisory arbitrage. In particular, it is important that supervisory convergence ensures that EU law's requirements for authorisations apply in a uniform manner and that outsourcing and delegations of functions back to the third country parent entity are subject to rigorous supervisory review so that the activities of these firms can be effectively supervised by EU competent authorities on an ongoing basis.

The baseline scenario would also need to consider further reprioritisation and stringent decision making of the tasks to be taken on board in order to meet mandates to the extent possible (deliverables) with current resources. The ESAs may also be unable to stretch the current powers further, in case sectoral legislation will confer them direct supervision of other cross-border actors.

The preferred options in the three key areas of the ESAs framework are mostly focusing on targeted changes to the current baseline scenario, rather than a complete overhaul. This is in line with the conclusion in the evaluation that the ESAs' framework has been working well in relation to the significant challenges that they had to face and despite the fact that the available means did not always allow them to meet their mandates in full. To ensure that the ESAs are able to cope with the growing workload and anticipate the changes to the supervisory framework coming from sectoral legislation, the changes include:

1. powers (targeted changes to clarify some powers, such as giving a formal role to the ESAs in the ex-post monitoring of the equivalence process, improving the ability for the ESAs to ensure the correct application of Union law, transfer of supervisory powers to the ESAs in targeted areas with predominantly third country or cross-border relevance);

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<sup>107</sup> These are recent developments that can be evidenced by press reports: Politico Pro Morning Exchange of 29/6/17, 7:10 AM CET for instance reports " London-based insurer MS Amlin will re-domicile its EU business Brussels. The company is the third, after QBE and Lloyd's, to announce it will strengthen its presence in the Belgian capital." Similarly, "Up to 1,000 bankers working for JPMorgan in the City of London are to be relocated to Dublin, Frankfurt and Luxembourg as a result of Brexit" according to **The Guardian of 4/5/17.**

2. governance (targeted changes include the expansion of the decision-making process, now restricted to national CAs, to independent members with voting powers, a new appointment process and role for the Chairperson that includes voting powers<sup>108</sup> and an independent Executive Board composed of members that are EU officials, replacing the Management Board); and
3. funding (targeted changes include removal of fixed proportions between EU funding and other funding, as well as replacement of national CAs funding with private sector funding).

As presented in the overview cost table (annex 11.4.4), the cumulative impact of preferred options would generate a funding gap (per ESA), i.e. an upper bound cost estimation over the baseline costs, quantifiable for the additional regular activities (excluding direct supervisory powers activities) around EUR 1,400,000 in one-off costs and EUR 3,520,000 in recurring costs (including 34 additional FTEs<sup>109</sup> and translation costs, but excluding overhead resources). Nonetheless, these costs are merely indicative, as the amount to be paid by individual entities will be calculated according to size indicators via secondary legislation. For the additional direct supervisory powers given to ESMA, the funding gap is estimated at around EUR 3,000,000 in one off costs and EUR 7,440,000 in recurring costs (including 73 additional FTEs, but excluding overhead resources).

Under the 2016 ESAs budget and assuming partial funding (at least 60%) by the private sector, the total cost for businesses (excluding costs for direct powers) can be estimated per head count at around EUR 1,301 per firm as weighted average (with a minimum of EUR 338 and a maximum of EUR 16,457). Assuming that businesses are either directly or indirectly paying (via national CAs) for the activities of the ESAs, this the baseline cost for businesses. With the changes to the current framework, these values (per head count) would increase to EUR 1,528 (with a minimum of EUR 383 and a maximum of EUR 19,549). In the scenario of a 100% funding by the private sector, the weighted average can be estimated at EUR 2,168 (with a minimum of EUR 563 and a maximum of EUR 27,429). Costs for direct powers will be charged directly to the supervised entities and will replace fees currently paid for national supervisors, for those entities that are not newly created. Due to a lack of data on the population of entities covered by the new direct powers, it is not possible to make an estimate of costs of new direct powers for businesses.

As a result, while the review may result in a significant increase of budget compared to current levels, the net impact on the private sector would be limited, while neutral on the EU budget (as it is in line with the current MFF).

No impact, in terms of costs, is expected on consumers.

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<sup>108</sup> Voting powers for Independent Members and the Chairperson would only be limited to non-regulatory issues

<sup>109</sup> We assume 1 FTE is equivalent to EUR 80,000 per year.

As a result of the cumulative impact of the preferred options, the ESAs will be better able to fulfil their existing mandates and ensure greater supervisory convergence in addition to the preparation of regulatory products. Enhanced supervisory convergence has the potential to reduce administrative burdens for all supervised entities and additional synergies in reducing compliance costs for cross-border ones, while preserving the system from supervisory arbitrage by market participants. There are three reasons for the ESAs' expected better performance: First, the incentive structure in the governance of the ESAs will be improved by balancing out incentives to protect national interests in the decision-making process so that, in particular, powers to promote regulatory and supervisory convergence can be used more effectively. Second, the decision to reduce the reliance on public funding from national CAs, to be complemented with private sector money, can ensure that the ESAs will be adequately resourced to perform their existing tasks and to adapt more easily to future changes. Notably, convergence powers can be used more widely and effectively if resources are readily available to carry out reviews of national practices. Finally, targeted amendments to certain parts of the ESAs' powers can ensure that the ESAs can perform their tasks efficiently and effectively in the light of the experience gathered during the six years of their existence, as well as developments in the various financial markets and in EU level legislation. These targeted changes are also aligned with the stakeholders' view that a greater coordination role by the ESAs is warranted and that ESAs should make better use of their existing powers;

The ESAs will be in a position to better coordinate national authorities and to exercise, where appropriate, direct supervision. This enhanced role of the ESAs can further market integration by facilitating cross-border business. This will be possible for three reasons: First, the ESAs will be equipped with improved and, where appropriate, new powers. Second, more flexibility of funding over time provides a solid basis for the supervisory system to cope with the increased workload and potential upcoming changes in the powers provided by sectoral legislation. Thirdly, the renewed internal governance is conducive to quicker and more independent decision making, which is important for direct supervision and the coordination of national authorities. Stakeholders have generally supported direct supervisory powers in limited areas.

Enhancing supervisory convergence and establishing a level playing field across the Single market with a uniform fee setting mechanism would enable ESAs to raise funds (under a clear and transparent mechanism respecting the principle of equal treatment in order to meet their current and future tasks and mandates in full. Such outcome would ultimately benefit all market participants. The implications to financial resources from the implementation of the preferred options are discussed in section 9.1. It is worth noting that the net impact of the preferred options on the national CAs budgets would be neutral. This is because, on the one hand, national CAs would stop contributing to ESAs funding and, on the other hand, they would reduce (in a proportionate way) their funding needs to cover for the additional duties that ESAs are increasingly taking on. The net impact on the market participants would depend on the model that national CAs currently use to fund themselves. For example, if market participants in a given Member State do not currently pay for their supervision (i.e., as in the case of fully publicly funded national CAs) then the implementation of the preferred options would result in increased cost for these market participants at the benefit of taxpayers and

national budgets in those Member States. Finally, in the case that market participants already pay for the ESAs via contributions to their national CAs' budgets then the net impact (incremental cost/benefit) of the implementation of the preferred options would depend on the various methodologies that national CAs use to charge fees to individual entities. To this extent, in order to come up with an accurate estimate of the incremental cost/benefit across the EU, a thorough comparative analysis would require the involvement of those national CAs applying own methodologies on fees allocation. In any case, the amounts required to fund ESAs, according to the simulation in Annex 11.4.3, would not pose a threat to individual entities' operational models.

More discussion on the impact to the various other categories of stakeholders from implementing the preferred options is presented in Annex 11.2.

### **9.1 Impact on EU budget**

The introduction of the preferred options under powers, governance and funding are not expected to adversely impact the EU budget. This is because the proposed funding methodology respects the ceilings provided by the MFF in force while allowing the ESAs to tap the additional funding they need from the private sector.

The current MFF defines the maximum ceilings for the EU contribution to the ESAs budget until 2020. In this regard, for the period 2018-2020 the preferred options could only have a limited impact on the EU Budget.

For the next MFF preparations, the ESAs should provide the Commission with a medium-term projection (covering at least 5 years) of their anticipated budgetary needs according to the methodologies they apply for preparing their annual budgetary proposals. In turn, the Commission will assess these requests against the background of policy objectives and budgetary constraints.

In the immediate future, with the exception of granting direct powers to an ESA<sup>110</sup>, a sizeable increase in the ESAs budget may not be necessary. As indicated in section 8.2.1.2, the ESAs pending regulatory work and subsequent supervisory work is mostly taken into consideration in each of the ESA's latest (multiannual) Single Programming Documents. In addition, in light of the Commission's commitment to regulate less but better, a dramatic increase in the level of regulatory acts that could justify an immediate sizeable increase in the ESAs' budgetary demands would not be expected.

Although, the preferred option under governance of setting up of a body with independent members will increase the costs of running the ESAs, the extent of the impact on their budget will depend on: (i) the number of posts to be created (it could differ between the ESAs given the extent of their respective responsibilities); and (ii) the level (grade) of these posts. This impact assessment also envisages the option of having ESA Senior Managers as Board

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<sup>110</sup> In the case of granting direct powers, there is a separate assessment of staffing and resources needs arising from the assumption of such powers and duties.

members, which would be less costly and could be done for some of the ESAs where their tasks and mandate would not justify the creation of entirely new positions. In the latter case, no impact to the ESAs (and thus EU) budget is expected. All other proposed changes in the governance structure should not impact on the EU Budget

Last but not least, it should be noted that any budgetary demands will still be subject to all accountability and audit mechanisms put in place in ESA Regulations, for the preparation, adoption and execution of their annual budgets. Moreover, the EU contributions to the ESAs and their establishment plans would still be authorised by the Parliament and the Council, and subject to discharge from the Parliament on a recommendation from the Council.

An overview of the indicative costs of the preferred options resulting from this report is presented in Appendix 11.4.5.

## 9.2 Overall coherence

With regards to **overall coherence**, the preferred options in the area of powers, governance and funding of the ESAs are coherent with the existing models of EU decentralised agencies while taking into account the specificities of the ESAs. Attributing the supervision of certain actors of systemic nature or activities of a primarily or almost exclusively cross-border nature to the ESAs is coherent with the general trend of transferring specific tasks to a decentralised EU agency when the cross-border component triggers the needs for an EU measure aiming at higher convergence within the EU. Inevitably, the attribution of more powers to the ESAs is subject to the limits imposed by treaties, as interpreted by the Court of Justice, on the delegation of powers to Union bodies.<sup>111</sup>

The targeted changes in the current governance model are also in line with the Commission's efforts to make decision making fora in the EU decentralised agencies more operational and independent. In the area of financial services other European agencies or institutions, such as the European Central Bank, which has an Executive Board or the Single Resolution Board have stable independent preparatory body, which has own powers and tasks, and can decide on certain issues or participate in the decision-making process. The establishment of an ESAs' Executive Board with permanent members and with an Exclusive ESA mandate is in line with the existing safeguards for enhancing the EU dimension in the agencies decision-making process. Moreover, the preferred option for the external appointment of the Chairperson to enhance his/her standing and role is also in line with the current practice as regards appointment of EU agencies' heads which aim higher legitimacy and accountability standards, as well as strong safeguards for the Heads' independence.

Finally, with regards to funding, the majority of the EU decentralised agencies are funded by the EU Budget. Still, there are several EU agencies which receive mixed of fully private funding. In that respect, the shift to industry contribution for the ESAs' budget is in line with existing EU practice. In addition, under the preferred option, the amount of the annual EU

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<sup>111</sup> Cf. Cases 9/56, Meroni, 98/80, Romano, and C-270/12, United Kingdom v Parliament and Council.

contribution to the ESAs will still be decided within the MFF in force. Moreover, the currently applicable legal framework for the EU decentralised agencies (the FFR) will continue to apply to the ESAs thus ensuring consistency with existing standards for budgetary process and control.

## 10 Monitoring and Evaluation

The ESA Regulations provide for evaluation of the ESAs every three years, starting from the effective start of its operation. As mentioned in Section 2.4., the Commission has issued an Evaluation report on the functioning of the ESAs.<sup>112</sup> Going forward, the Commission will continue to monitor the functioning of the ESFS and to report accordingly. The Commission's systematic evaluation of the ESAs will include extensive consultation, in particular of the Financial Services Stakeholder Group.

The specific indicators identified in the impact assessment accompanying the Commission's proposal for setting up the ESAs match with the ESFS specific objectives and remain valid for the current and future evaluations. These indicators serve to assess the performance of the ESAs in fulfilling their tasks and they also depict the ESAs' specific powers governance structure and funding sufficiency. The following table presents the main areas of activity of the ESAs and matches them with some relevant indicators:

Objective	Proposed indicator
<b>Implementing/regulatory technical standards, guidelines, recommendations</b>	<ul style="list-style-type: none"> <li>• Number of adopted technical standards relative to those required to be developed</li> <li>• Number of draft technical standards submitted to the Commission for endorsement within the deadlines</li> <li>• Number of technical standards proposed but rejected by the Commission</li> <li>• Number of adopted non-binding recommendations relative to those required to be developed</li> <li>• Number of requests for explanation by CAs</li> </ul>
<b>Consistent application of EU rules</b>	<ul style="list-style-type: none"> <li>• Number of investigations of breach of EU law successfully closed</li> <li>• Average duration of an investigation of breach of EU law</li> <li>• Number of warnings on manifest breach of the EU law</li> </ul>
<b>Mediation</b>	<ul style="list-style-type: none"> <li>• Number of successful mediations without binding settlement</li> </ul>
<b>Common supervisory culture</b>	<ul style="list-style-type: none"> <li>• Number of colleges with EBA / EIOPA / ESMA participation</li> <li>• Number of bilateral meetings with CAs</li> </ul>

<sup>112</sup> Add reference.



	<ul style="list-style-type: none"> <li>• Number of joint on-site inspections</li> <li>• Number of hours training for supervisors</li> <li>• Number of staff participating in exchanges / secondments</li> <li>• Number of peer reviews conducted</li> <li>• Number of obstacles to convergence identified and removed</li> <li>• New practical tools and instruments to promote convergence</li> </ul>
<b>Consumer protection</b>	<ul style="list-style-type: none"> <li>• Number of initiatives on financial literacy and education</li> <li>• Number of analytical studies published</li> </ul>
<b>Direct supervision of pan-European financial institutions</b>	<ul style="list-style-type: none"> <li>• Number of on-site inspections and dedicated investigations</li> <li>• Number of meetings with supervised entities</li> <li>• Number of complaints / appeals from supervised companies</li> </ul>
<b>Management of emergencies</b>	<ul style="list-style-type: none"> <li>• Number of formal decisions adopted addressing emergency situations</li> </ul>
<b>Micro-prudential information management</b>	<ul style="list-style-type: none"> <li>• Number of populated databases</li> </ul>
<b>Stress testing</b>	<ul style="list-style-type: none"> <li>• Number of stress tests or equivalent exercises carried out</li> </ul>
<b>Funding sufficiency</b>	<ul style="list-style-type: none"> <li>• Ratio of proposed versus adopted final budget (per annum)</li> </ul>

The ESAs should collect data on these indicators on an annual basis. In addition at the beginning of each year ESAs should (where applicable) set targets vis-à-vis indicators. Targets can be of either numeric (e.g. % increase/decrease) or of qualitative nature (e.g. positive/negative trend) compared to the previous year.

The final set of indicators is decided by the Commission in sufficient time in advance to allow ESAs to collect annual data prior to an evaluation. The evaluation should seek to collect input from all relevant stakeholders, but in particular national CAs, EU institutions and fee paying sectors and entities under the remit of ESAs. Input will also be required by ESAs.

The evaluation will be repeated every 3 years after the application of these amendments.

## 11 Annexes

### 11.1 Procedural Information

**Lead Directorate-General:** Directorate-General for Financial Stability, Financial Services and Capital Markets Union (FISMA).

The initiative is included in the **Commission Work Programme 2017** as agenda planning item 2016/FISMA/009.

**Organisation and timing of Inter Service Steering Group's meetings:** three meetings on 25 April, 2 May, 31 May and 12 June 2017. The Inter Service Steering Group included representatives of the Economic and Financial Affairs (ECFIN), Internal Market, Industry, Entrepreneurship and SMEs (GROW), Justice and Consumers (JUST), Budget (BUDG), the Legal Service (LS), Task Force 50 (TF 50) and the Secretariat General (SG).

#### *Evidence used in the impact assessment*

Following the First Commission's report on the ESAs (2014), in the first half of 2015 the Commission Services conducted a **fact-finding exercise**, to map the variety of funding models in place across the EU with respect (mainly) to national authorities. The divergence of models in place across Member States today is significant. Some Member States fully fund their authorities through public monies; others are funded wholly by the private sector; while other Member States have a hybrid system. These models may also vary for different supervisors (where Member States have a number of competent authorities responsible for different aspects of financial services regulation). Different approaches may also be taken to calculating the contributions from different types of market participants within the financial sector (where private funding is in place). In addition, some national competent authorities already pass on their share of the cost of funding the ESAs to the firms they supervise.

Understanding the plethora of existing arrangements in place today is critical to the development of the Commission's thinking with respect to ESA financing, and in putting into practice our strong commitment to Better Regulation and evidence-based policymaking.

In September 2015 the Commission launched a call for evidence to consult all interested stakeholders on the benefits, unintended effects, consistency, gaps in and coherence of the EU regulatory framework for financial services. The ESAs were included within the remit of this exercise. A number of respondents highlighted amongst other things the need to consider the scope of ESA guidelines, the ESAs role in strengthening supervisory convergence, the ESAs role in pursuing breach of EU law cases and how to increase their focus on enforcement.

On 21 March 2017 the consultation is designed to gather evidence on the operations of the ESAs focusing on a number of issues in the following broad areas: (1) tasks and powers; (2) governance; (3) supervisory architecture; and (4) funding. The aim is to identify areas where the effectiveness and efficiency of the ESAs can be strengthened and improved, while respecting the

legal limitations imposed by the EU Treaties. The results should provide a basis for concrete and coherent action by way of a legislative initiative if required. This consultation responds to the requirements for evaluation set out in Article 81 of the ESA Regulations.<sup>113</sup> It complements the public consultation carried out in late 2016 to review the EU's macro-prudential framework including the European Systemic Risk Board ("ESRB").<sup>114</sup>

### *Consultation of the RSB*

<b>Main considerations</b>	
<b>Board's recommendation</b>	<b>Response to Board's recommendation</b>
(1) The analysis of challenges for the supervisory systems related to the likely evolution of banking, insurance and securities markets over the next years remains incomplete. It also fails to address sufficiently the various impacts of the United Kingdom's withdrawal from the EU on the core activities of the ESAs.	<p>The impact assessment has been revised to more clearly explain that the policy initiative is for the sake of the EU Single Market and its integration and follows on the commitment announced in the 5 Presidents Report and the subsequent commitment expressed in the various Commission follow-up Communications (most recently in the Reflection paper on the deepening of the EMU, to move towards a genuine Financial Union, including single supervisors for capital markets. The departure of the United Kingdom and its consequences has been more accentuated where and to the extent appropriate throughout the main chapters of the Impact Assessment. For example, there are now more than 20 sentences mentioning impacts of the United Kingdom's withdrawal from the EU on the core activities of the ESAs.</p> <p><u>Revised chapters:</u> Throughout the IA</p>
(2) The evaluation does not provide a solid basis for policy development. It appears to be based on selective reporting of stakeholders' views and unreferenced and unsubstantiated desk work.	The evaluation has been revised to better distinguish between assessment and argumentation related to desktop work from opinions resulting from stakeholders consultations. Some more discussion has been added and where feasible evidence has

<sup>113</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, p. 12; Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, 48; and Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, p. 84.

<sup>114</sup> For the macro-prudential leg of the ESFS, see the consultation that was published in August 2016 and the following summary report published in December 2016.

	<p>been added to improve the evaluation. There are limitations to the type of evidence used; some parts of the evaluation rely heavily on anecdotal evidence and stakeholder experiences with the ESAs. To compensate for that there has been an attempt to provide many examples from various different information sources, e.g., the governance. Other parts, such as funding, rely on more references and substantiated arguments.</p> <p>The evaluation is also a retrospective exercise which is a backward looking exercise comparing the past years with the baseline scenario which is one in which the ESAs do not exist. The evaluation therefore by its very nature focuses less on the need for new, additional direct supervisory powers necessary for ESMA.</p> <p><u>Revised chapters:</u> Chapter 11.5 (Evaluation Annex)</p>
<p>(3) The assessment of costs and funding gaps of ESAs implied by the baseline and the various options remains incomplete.</p>	<p>More discussion and quantification has been provided of the resources needed for the ESAs to take on additional tasks (direct and indirect powers); the impact on resources resulting from governance modifications and the impact on resources from changes in the funding methodology for indirect supervision.</p> <p>Costs between direct and indirect supervision and other activities have been differentiated and who is bearing the cost of preferred options has been better explained.</p> <p>The discussion on net impacts (in terms of costs) of preferred options have been further developed to better address the issue of funding gaps and impact of overall supervisory costs for the sector.</p> <p>In particular,</p> <ol style="list-style-type: none"> <li>1. The overview cost table has been updated in line with the legislative financial fiche. We now have a very detailed estimation of costs and impact of both changes to the current ESAs framework and for the new</li> </ol>

	<p>direct powers.</p> <ol style="list-style-type: none"> <li>2. The comparing options section in funding has been completely redrafted, as requested, to reflect the full costs and benefits of option 3 compared to the baseline and option 2 in particular.</li> <li>3. The collection mechanism section has been completely redrafted to meet IA standards and added to the main text as this is part of the legislative proposal.</li> </ol> <p>Regarding the net impact to the individual sectors, this could not be assessed exhaustively at this stage as it depends on the model used to finance national CAs within a Member State. For example, if market participants in a given Member State do not currently pay for their supervision (i.e., as the case of fully publicly funded national CAs) then, by definition, the allocation methodology of the preferred option would result in increased cost for these market participants at the benefit of taxpayers and national budgets in those Member States. At the same time, if market participants already pay for the ESAs via contributions to their national CAs' budgets then the net impact (incremental cost/benefit) would depend on the various methodologies that national CAs use to charge fees to individual entities as well as the weights they apply to entities for ESAs funding. In this case, in order to come up with a precise, reliable estimate of the incremental cost/benefit across the EU, a thorough comparative analysis is needed, which would require the involvement of those national CAs applying own methodologies on fees allocation. In any case though, it could be reasonably argued that establishing a level playing field across the Single market with a uniform fee setting mechanism among financial entities would ultimately benefit all market participants. In addition, it should be noted that the amounts required to fund ESAs should not, in principle, pose a threat to individual entities' operational models.</p>
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	<p><u>Revised chapters:</u> Chapter 8 (Funding) and 11.4.4 (Annexes – Overview of costs of preferred options)</p>
<p>(4) The comparison of options remains unconvincing and the choice of the preferred option is not sufficiently supported by available evidence and analysis.</p>	<p>More detailed descriptions and further additions to the options description and analysis has been made to the extent available.</p> <p>The discussion on powers is substantiated by further information and argumentation in the annex to the impact assessment. The lack of evidence to support the preferred option in the power section can in some instances be explained by the fact that the policy direction in some cases have been motivated by a political decision.</p> <p>The discussion on options in the governance section has been extensively explained and substantiated with examples and anecdotal evidence as well as underpinned by the results of evaluations made both by the European Parliament and the Commission. The nature of the defined problem in governance makes it very difficult to obtain hard core verifiable data.</p> <p>In relation to funding, the section on the preferred option has been improved to add additional assessment elements and to better clarify existing argumentation.</p> <p><u>Revised chapters:</u> Chapter 8 (Funding), Chapter 9 (Cumulative impact of the chosen options), Chapter 6 (Powers)</p>
<p><b>Response to other considerations &amp; adjustment requirements</b></p>	
<p><b>Board's recommendation</b></p>	<p><b>Response to Board's recommendation</b></p>
<p>I. Clarify the baseline</p>	<p>The consideration has been addressed by slightly accentuating the departure of the United Kingdom and its consequences where and to the extent appropriate throughout the main chapters of the Impact Assessment. As negotiations with the United Kingdom are ongoing there are limitations to how much could and should be said about the hypothetical future once the United Kingdom</p>

	has left the EU. See also DG FISMA response on point 1 of main considerations in the previous section.
II. Increase the objectivity of the evaluation and present its limitations transparently.	The consideration has been addressed to the extent possible; please see DG FISMA's response to point 2 of the main considerations in the previous section.
III. Improve the analysis of costs and the funding gap.	Chapters 8 and 11.4.4 have been revised accordingly in order to improve the analysis of costs and provide further quantification on the funding gap.
IV. Complete the range of options and better justify the final policy choices.	<p>In the areas where this was requested – especially in relation to powers and funding, the choice of the preferred options has been better justified to the extent that evidence has been available; please see DG FISMA's response to point 4 of the main considerations in the previous section.</p> <p>Regarding the completion of the range of options based on the evaluation discussion, the current range of options provided in the respective sections<sup>115</sup> could only be expanded in the case where additional items are <u>genuine alternative options</u>.</p> <p>It was difficult to argue that a hypothetical scenario where the ESAs are sharing some of their activities (e.g. economic analysis, data management, HR, fees collection) is a genuine option. This is because in the evaluation section, the impact assessment concludes that "<i>Overall, it seems that in the European supervisory context the potential benefits from merging a number of more administrative activities and processes across ESAs would be limited, with uncertain efficiency gains</i><sup>116</sup>".</p> <p>Moreover, introducing "<i>full EU funding</i>" or a "<i>triple source funding model (EU, NCA and direct private funding)</i>" scenarios as additional options are not genuine alternatives to the baseline scenario mainly because the first scenario (full EU funding)</p>

<sup>115</sup> Sections 6 (Powers), 7 (Governance) and 8 (Funding)

<sup>116</sup> See Chapter 11.5, section "Evaluating the effectiveness and efficiency of the supervisory architecture", on p. 172 of the IA

	<p>maintains, if not exacerbates, all the inefficiencies of the baseline discussed in the public funding section (see section 8.4.1) and the second scenario (triple source of funding) is the actually the existing baseline.</p>
<p>V. Better present the stakeholders' views.</p>	<p>All efforts have been made to better present stakeholders' views in the impact assessment and in particular in the Evaluation (Chapter 11.5) as stated on point 2 of main considerations in the previous section. It should be considered that some of the issues relating especially to the new powers of ESMA were added to the policy discussion after the launch of the public consultation. This explains the absence of stakeholder views on some of the issues relating to the transfer of powers to ESMA.</p>



## 11.2 Stakeholder consultation – Synopsis report

### 1. INTRODUCTION

In 2014 the Commission adopted a review report ("**2014 Review Report**") on ESFS covering the operations of the ESAs and the ESRB. With respect to the ESAs, the Review Report concluded that a number of issues could be considered for improvement in the following four categories: funding, governance, tasks and powers, and the institutional structure of the ESAs.

The **Parliament's 2014 resolution on the ESFS review**, requested that the Commission submit new legislative proposals for the revision of the ESAs in the same areas identified in 2014 Review Report. To this can be added that in its 2013 review of the ESAs, Parliament pointed out that one of the key matters for a future review of the ESAs is to assess whether sectoral supervision is still appropriate.

The **Council conclusions from November 2014** that targeted adaptations should be considered to improve, in particular, the ESA's performance, governance and financing.

In **September 2015** the Commission launched a **call for evidence** to consult stakeholders on the benefits, unintended effects, consistency, gaps in and coherence of the EU regulatory framework for financial services. A number of respondents highlighted amongst other things the need to consider the scope of ESA guidelines, the ESAs role in strengthening supervisory convergence, the ESAs role in pursuing breach of EU law cases and how to increase their focus on enforcement.

The intention to strengthen the effectiveness and efficiency of supervision at micro-prudential and macro-prudential level was also confirmed in the **2017 Commission work programme**. This coincides with the fact that the ESAs founding Regulations also mandate a general review of the operation of the ESAs this year.

A 3-month open public consultation was launched on 21 March 2017. Views, evidence and other information gathered through this public consultation assisted the Commission in identifying weaknesses, strengths, gaps and overlaps that different stakeholders are facing under the current framework.

### 2. Public consultation on the ESAs Review 2017

In total 227 respondents participated in this consultation: 161 (71%) are private organisations or companies half of which were industry associations, 59 (26%) are public authorities many of which are regulatory authorities and ministries and 7 (3%) are private individuals. In terms of location of the activities, most of the respondents are from Belgium (18%), Germany (18%), the United Kingdom (11%), France (10%) and Italy (6%). No replies have been sent from participants located in Latvia and Romania. The fields of activities of the respondents

are almost equally spread between various activities, from which insurance (24%), banking (23%) and investment management (20%) are the most represented.<sup>117</sup>

## TASKS AND POWERS OF THE ESAS

### A. Optimising existing powers

The vast majority of the respondents strongly support ESAs' mandate on **supervisory convergence** and positively assess the results while recognising the scarce resources and the short time of the ESAs' existence. However, many industry representatives recall the need for ESAs, especially EIOPA, to respect the limits of their mandate. While many respondents object to significantly increasing ESAs' powers at this stage, some recognise their limitations and would like to see targeted improvements. Most respondents argue the available tools broadly suffice and should be more fully used.

Many respondents find ESAs' involvement in cross-border cases positive. Many private sector respondents feel that ESAs should get involved more frequently while a few others, primarily from the public sector, argue ESAs should only be entrusted with new powers in cross-border or systemically relevant cases. Some also recognise that the underlying legislation in this area is not sufficiently solid.

Stakeholders point to some weaknesses *e.g.* little, if any use of binding mediation, breach of union law, emergency procedures and insufficient transparency in ESAs' activities. Several industry representatives suggest changes to ESAs' governance and decision-making process to facilitate greater use of existing tools. Some respondents, mostly from the private sector, cite cases where ESAs had not acted at all, very late, or not communicated actions publicly. Some stakeholders also reckon that the ESAs have developed a culture of compromise which is not compatible with ESAs' supervisory convergence activities.

The vast majority of respondents identify weaknesses in the definition and application of ESAs' tasks and powers on **guidelines and recommendations**. Recommendations include the introduction of scrutiny by legislators, adopting guidelines only when strictly necessary, increased openness and transparency by consulting stakeholders or conducting impact analyses (especially for costs of compliance). While many stakeholders welcome them, some industry representatives feel guidelines and Questions & Answers are used too extensively by ESAs.

Some stakeholders consider **peer reviews** a useful instrument and ask the Commission to encourage ESAs to devote more resources. Some stakeholders see room for improvement by increasing transparency, taking into account the views of the industry in the peer review

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<sup>117</sup> The percentages given in this factual summary correspond to the responses submitted by stakeholders to the open public consultation. Beyond a statistical analysis of the data, the summary also provides a qualitative assessment of the valued opinions and input received to the functional mail box or to the Commission's officials without using the EU survey.

process, conducting more focused peer reviews, and emphasising "best practices" in terms of supervisory practices and application of EU laws. Some stakeholders also underline that more attention should be paid to the follow-up of peer reviews, in order to guarantee the implementation of recommended measures. EBA suggests adding the possibility of focused reviews on a limited number of competent authorities.

Only few stakeholders comment on **binding mediation**, as the ESAs have not issued binding mediation so far. Several stakeholders underline that binding mediation should be explicitly mandated in Level I legislation, especially where there is a clear consensus on the need for a high level of regulatory and supervisory harmonisation across the EU.

Many respondents consider **colleges of supervisors** useful instrument of supervision/supervisory convergence which allow for sharing information among regulators. However, several stakeholders argue the high number of representatives in college meetings makes efficient supervision difficult. Therefore, it would be important to clarify the working methods and the role of each participant, as well as the lead supervisor's responsibilities.

In terms of **new tools**, many stakeholders, primarily from industry but also including ESMA, suggest exploring the possibility for ESAs to issue documents similar to no-action letters used by other supervisors (e.g. in the US) to remove or temporarily suspend certain obligations. This, they argue, could provide the necessary flexibility in the process of applying new regulations in certain cases or may be needed to ensure orderly markets and financial stability.

Other respondents, including EBA and ESMA, suggest to more systematically involve the ESAs in the discussions on Level I legislation. The ESAs should notably be allowed to: 1) Advise on the substance of the legislation as it is developed and identify areas where Level I measures are needed to foster supervisory convergence or might inhibit it, and 2) Provide input into the feasibility and appropriateness of Level II mandates.

Many public authorities and industry associations found that the scope of ESAs' tasks and powers on **consumer protection** is adequate and should not be extended. Instead, they should use their existing powers more efficiently. However, some other public authorities see room for extending ESAs' powers, e.g. by giving ESAs the right to prohibit or restrict certain products for investor protection purposes, and want to see more work in the financial innovation space, including on virtual currencies and innovative uses of consumer data. Some industry organisations want ESAs to do more e.g. on financial education, cross-border protection, big data etc.

All three consumer organisations see significant shortcomings with enforcement, either viewed as inefficient or detached from most detrimental problems at national level. They also see a need for extending the ESA's fields of activity. Some of them advocate a twin peak model of supervision i.e. separating market conduct from prudential supervision. A few organisations found that the ESAs' powers to ban products should be extended to those that are prone to consumer detriment.

A few public authorities argue the Joint Committee (JC) should have a stronger role and cross-sectoral issues should be dealt with by it. EBA calls for clarifications in its founding regulation to keep pace with the range of consumer protection legislation.

Only half of the respondents express a view on the need for adjusting the ESAs' tasks and powers on **breach of EU law investigations**. The majority of those, predominately public authorities, do not see the need to adjust the ESAs' tasks and powers in order to facilitate their actions on breach of Union law. Respondents recognise that such powers have not been fully tested yet, and it would therefore be difficult to assess the existing mechanism's full potential.

Other stakeholders believe that the breach of Union law procedure should be modified. Specific suggestions for reform include an obligation for the ESAs to duly motivate and publish any decision not to launch a breach of Union law investigation, or allowing on-site inspections to national CAs in the context of breach of Union law investigations. Others propose that breach of Union law decisions could be taken by a modified executive board with a Commission representative with veto powers. ESMA argues for a clarification in the ESMA Regulation that Article 17(6) powers also relate to provisions of Directives that establish unconditional obligations that are sufficiently clear and precise to be directly effective. ESMA also suggests adding financial reporting, corporate governance and auditing to the scope of breach of Union law procedures.

With regards to **the international aspects of the ESAs' work** half of the respondents give a clear answer in relation to extending ESAs tasks in the area of monitoring and implementing equivalence and increasing the role in co-ordinating national CAs' dealings with third country authorities. A clear majority, including all ESAs, support increasing ESAs' responsibilities in ex post monitoring and implementing equivalence decisions. Nearly a third of respondents to this question would also welcome more general changes to the EU equivalence framework (e.g. introducing a more horizontal approach, increasing transparency, predictability, ensuring reciprocal treatment of EU firms and overall increasing robustness and adequacy of the framework in view of the UK's decision to leave the EU).

About a quarter of respondents, including EBA and EIOPA, see a role for the ESAs in preparing initial equivalence assessments. A comprehensive equivalence assessment should include the initial equivalence assessment, follow-up to assess the frameworks' implementation and monitoring upcoming changes. Few suggest that ESAs should have the final say on that matter, while a much greater number of replies supported a continued Commission role in adopting those decisions.

ESMA also argues for the supervisory and enforcement powers at EU level to be conducted by it for third country entities such as: Credit Rating Agencies (CRAs), Trade Repositories (TRs), CCPs, benchmarks and data providers.

The vast majority of respondents, both public institutions and private entities, consider that the current **ESAs' power of access to information** is sufficient to enable them to fulfil their mandate. The industry mainly points to risks of duplication and costs linked to answering

more direct requests. Many public authorities highlight the underuse of the information received by the ESAs already now.

Few stakeholders, mainly industry associations, recognise some deficiencies as regards the handling of data. They point to fragmentation of and lack of consistency in data collection in the Union and duplications of data requests. Exactly in these areas they see a role for the ESAs, e.g. to streamline the data collection by identifying overlaps and gaps. A stronger coordination with the national CAs could also bring benefits in that respect. Few stakeholders suggest ESAs establish a central information hub which could overcome many of the shortcomings in this area.

Most respondents favour a greater coordinating role for ESAs in the field of **reporting** – while acknowledging the complexity of the task and welcoming ESAs' efforts to date. Some favour ESAs as the only collection point, others a centralised hub (with a few pointing out that existing hubs deliver the desired results). Some public authorities warn about the high costs of such hubs. However, many other respondents, primarily public authorities, feel data should be collected by national CAs. Whether gathered by ESAs or national CAs, many respondents argue data should be available to both. ESMA also calls for a legal basis so it can use all data collected for all of its objectives (subject to anonymisation).

Many respondents, mostly from the private sector, bemoan duplication or differences in reporting requirements. Most suggest better coordination between national CAs and ESAs, but also with other relevant organisations. The vast majority of respondents favour ESAs' efforts to streamline (and reduce) reporting requirements.

Many public and private sector respondents support the idea of a simpler adoption process for implementing technical standards on reporting. Some respondents favour ESAs adopting own implementing technical standards with the Commission maintaining the right of scrutiny.

An overwhelming majority of respondents argue there is no need to strengthen enforcement and supervisory convergence in the field of **financial reporting**. Enforcement should remain a national responsibility. Some of the respondents acknowledge that there is room for further convergence. Some banks, banking associations and securities markets regulators are of the view that ESMA should be able to launch a breach of EU law process concerning substantive financial reporting requirements. Most investors' associations are of the view that supervisory convergence should be improved in both financial and non-financial reporting by strengthening ESMA's role.

Regarding possible synergies between enforcement of accounting and auditing standards, a vast majority of stakeholders express doubts. Some stakeholders see benefits in strengthening cooperation and sharing information between securities markets and audit regulators.

Regarding the supervisory framework in the field of auditing almost all respondents consider that the current configuration should not be changed. In particular, they oppose integrating the Committee of European Auditing Oversight Bodies (CEAOB) into ESMA. The overwhelming majority of industry associations, companies and public authorities were in

favour of specialised bodies and did not see evidence for benefits resulting from a strengthened role of ESMA in the field of audit oversight. Many stakeholders were in favour of keeping enforcement powers at the national level and highlighted the importance of the independence of standard setters. ESMA raised the possibility to add auditing to Article 1(2) of the ESMA Regulation to enable it to use breach of Union law procedures as an instrument to enhance supervisory convergence in this area.

All public authorities in charge of audit oversight were strongly against giving ESMA a greater role in audit oversight. Instead they favoured giving the CEAOB more time for consolidating since it has only been established one year ago.

The vast majority of respondents are of the view that there is no reason to change the current endorsement process or the role of European Financial Reporting Advisory Group (EFRAG). EFRAG has been operating successfully under the new governance structure since November 2014 following the implementation of the Maystadt recommendations. These stakeholders believe that strengthening the role of ESMA could be counterproductive as ESMA would consider the standards only from the perspective of investors. A clear separation of powers between standard setting and enforcement should be maintained to avoid conflict of interest.

## **B. New powers for specific prudential tasks in relation to insurers and banks**

The consultation set out remaining inconsistencies in the requirements for **internal models**, leading to a lack of supervisory convergence. Some respondents acknowledge that the approval of internal models raises issues, e.g. inconsistencies in terms of what national CAs require and approve, the evidence they accept, their approach to expert judgment and the time they take to decide on the application.

National CAs sitting on EIOPA's Board of Supervisors as well as some ministries of finance, were of the view that granting **EIOPA powers to approve and monitor internal models of cross-border groups** could lead to more consistent decisions and supervisory approaches, would make the decision process more effective, reduce administrative burden and avoid supervisory arbitrage. By knowing industry-wide good practices, EIOPA could also effectively challenge the modelling techniques and develop an early warning system to indicate potential threats to the appropriateness of the internal model.

Some other respondents, on the other hand, emphasise that for the approval of an internal model, knowledge of the specificities of the insurer and the group, the risk factors and profile, as well as the local market, are required and that national supervisor are best placed in that respect. The vast majority of the insurance organisations argued that the division between national CAs and EIOPA should remain as it is, with a focus on supervisory convergence for example by improving EIOPA's participation in colleges of supervisors' internal model work, benchmark studies or peer reviews on internal model approval processes.

Only few stakeholders express a position on ESAs' powers on **mitigating disagreement regarding own funds requirements for banks** and most of them, mainly supervisory authorities/central banks support the status quo due to the need of specific knowledge of local

market or national legislative framework. On the other hand, EBA calls for clarifying, and providing explicit grounds, for its role in ensuring the consistency of own funds instruments across the EU with the Capital Requirements Regulation.

Few respondents suggest **new powers or tasks in or related to banking**, i.e. EBA to have powers to suspend the application of regulatory requirements to firms (the so-called 'no-action' letters); a power to review ESAs' own level II measures; supervisory powers on shadow banking entities; powers in the area of payments supervision.

As regards **possible new powers for EIOPA**, very few respondents suggest EIOPA could develop an internal database for exchange of supervisory information, according to standards already in place for banking. Others propose that, in light of the large diversity of national guarantee schemes, EIOPA could develop a network of national insurance guarantee schemes in order to, for instance, assess their adequate funding.

### **C. Direct supervisory powers in certain segments of capital markets**

With regards to a **possible extension of ESMA's direct supervisory powers in the context of the CMU**, the vast majority of the respondents (of whom the majority are stakeholders representing an organisation or a company) support direct ESMA supervision of **CCPs** and centralising ESMA's powers (via supervisory colleges) to overcome the current fragmentation and inefficiency. The key reasons to support this position are the increased cross-border activity, systemic importance of CCPs and access to liquidity in the Euro area. The decision of UK to leave the Union is also named by some respondents as a reason why ESMA should be given direct supervisory powers, considering the large share of EU clearing market currently based in the UK. The following advantages of granting ESMA direct supervisory powers over CCPs have been outlined: uniform application of the regulation throughout EU, avoidance of regulatory arbitrage, avoiding complexities in the event of a CCP resolution when several national CAs with conflicting priorities might be involved.

A few of the respondents, predominantly public authorities, that generally approved the extension of the supervision powers of ESMA argued that the current regime of the colleges of supervisors is working well and should be maintained as the principal way of supervision of the CCPs. The arguments given by these respondents include a lack of financial resources ESMA might need in cases of failing CCPs, the fact that CCPs are posing a systemic risk within their home country, which is why the supervision should be kept at a national level, increased costs and over-complicated procedures for smaller CCPs that operate at national or regional level only.

Only few stakeholders, mostly from industry, addressed the question of **data providers**. Of those, a majority, including ESMA, fully supported the idea of direct supervision of data providers by ESMA – while many other respondents gave qualified support to the idea. Some respondents distinguish between consolidated tape providers (support for direct supervision) and ARMs and APAs, arguing that the latter should only be directly supervised by ESMA if

they provide cross-border services. However, some respondents, including market infrastructure companies, argue that with MiFID II only entering into application in 2018 and in the absence of an extensive impact assessment it would be premature to consider giving ESMA direct supervisory powers of data providers.

Among those stakeholders replying on direct supervision of the **asset management industry** a number of responses do not see this as desirable because ESMA is not in a position to adequately address national markets' needs. Other replies – particularly of parts of the industry which are active across borders - recognise potential merits in ESMA's direct supervision of EU regulated investment funds or those which conduct cross-border activities and highlight the usefulness of the creation of a knowledge hub at ESMA level and potential direct responsibility for passporting tasks.

## **GOVERNANCE**

Only half of the participants to the public consultation assess the current governance set-up of the ESAs. Views on the ESAs governance structure diverge: about a third of respondents provided a broadly favourable opinion of the ESAs' governance structure. These respondents were mainly public authorities, notably central banks and supervisors, as well as some industry associations. For them the current allocation of decision-making to national CAs was appropriate and efficient given their acquaintance with national markets and their competence. EBA believes that the current governance structure has performed well. However, if changes are introduced EBA favours limiting such adjustments to areas in which the decision making process could turn out to be excessively complex or insufficiently independent, such as mediation or breach of Union law.

Many other stakeholders took a more critical view of the ESAs governance. The arguments put forward varied and related to issues such as composition and structure of the decision-making bodies, voting powers or ESAs' ability to use their powers.

Regarding the possibility of introducing independent board members to the ESAs' Boards, almost all respondents from the public sector (governments and regulators/supervisors) either do not respond to the question (about half of them) or oppose the idea. The key arguments against include the perception that the current governance structure has allowed the ESAs to fulfil their mandate, as well as implied costs and the risk of a disconnect between the ESAs and the national CAs, who are ultimately responsible for implementing the rules, going against the reliance on national expertise and preventing the buy-in from these authorities.

There is no one industry-wide preference. Those supporting the change highlight enhanced stability and continuity within the Boards, efficiency of decision-making as independent members would be better able to take decisions with an EU perspective. It is argued that this should help contribute to the consistent application of legally binding acts and prevent regulatory arbitrage, in line with the tasks and powers of the ESAs.



Several stakeholders point to conflicts of interest inherent to the current governance structure, citing national biases (preventing binding mediation and breach of EU law procedure). Few comment on the allocation of tasks between the two Boards, but many of those suggest shifting enforcement powers to a Management Board (or Executive Board), for instance breach of union law, binding mediation procedures, peer reviews, as those tools are considered to have been underused.

Some respondents also suggested adjusting national CAs' voting share to the size of their sector. Many respondents commented on EBA's double-majority decision-making. Respondents from Banking Union countries argue for its removal, given the UK's decision to leave the EU, while respondents from non-Banking Union countries favour its maintenance. EBA suggests reconsidering these arrangements and also the status of the SSM and SRB on its board, as the current situation generated an artificial disconnect between regulatory and supervisory functions.

With regards to the Management Board almost all respondents from the public sector (notably supervisory authorities sitting on ESAs' Boards) support the current role and composition of the Management Board. They consider the governance structure appropriate and sufficient in order for the ESAs to deliver on their mandate.

Two representatives of national public authorities, however support enhancing the Management Board by granting direct powers and tasks to it and by creating permanent members, which would strengthen the EU perspective in decision-making. The large majority of respondents from the industry and academia share this view.

Furthermore, some respondents also suggest that binding mediation, breach of union law procedures and peer reviews could be delegated to the Management Board so as to achieve a more efficient decision-making processes.

A majority of respondents, mainly regulatory authorities, supervisory authorities and central banks do not support extending the role and mandate of the **Chairperson** as they consider the current system to be efficient. However, the majority of industry associations agree that the mandate of the Chairperson needs improvement, for instance by giving them a casting vote in the executive board or by foreseeing formally delegating more powers to them and allowing them to take decisions without the approval of the Board.

Most respondents agree that it is difficult to ensure a proper balance in the **stakeholder groups** together with the geographical balance. Representatives of consumers and users complain that they are outnumbered by the representatives of financial institutions and thus the opinions of stakeholder groups are not balanced. Financial institutions complain that representatives of consumers do not have sufficient technical knowledge and that their input is sometimes general and off-target.

## ADAPTING THE SUPERVISORY ARCHITECTURE

Almost half of the respondents do not reply to the questions while a few of them explain there is no optimal architecture of financial supervision and it is difficult to choose a model in abstract terms.

The vast majority of the given replies (which includes EBA and EIOPA) find that the current sectoral supervision functions well and satisfactorily and do not support any significant changes to the current supervisory architecture, such as shifting to the twin peaks model. According to many stakeholders, the current sectoral supervision allowed developing sector specific expertise which is needed in view of the increasing complexity of the legal framework. Representatives of the insurance sector are particularly opposed to change, highlighting important differences between the features of the banking and insurance sectors. Moreover, a number of stakeholders note that the current model allows for ensuring consistency between prudential supervision and conduct of business supervision, leading to the needed legal certainty. Many stakeholders question the real synergies coming from the possible merger of EBA and EIOPA since the hierarchy for the two sectors should be separate. Furthermore, they argue that two different boards of supervisors, one for banking and one for insurance, would be needed to ensure that there is sufficient competence to take decision on very complex issues. A few stakeholders express concerns that a merged banking/insurance authority would be dominated by banking regulatory approaches.

Some stakeholders argue that it is too early to reform the ESFS because it has not had the time to demonstrate its full potential, in particular in the area of supervisory convergence.

Some stakeholders, mainly industry representatives and academia, are critical of the sectoral supervision model for various reasons. Many of them highlight that the model is outdated and ignores the reality of the retail financial markets in Europe.

## FUNDING

While a majority of the respondents answer whether the ESAs should be fully or partly funded by the industry, less than a sixth replied on what would be the most efficient system for allocating the costs of ESAs' activities. Less than a quarter answered the question on fee collection.

The majority of respondents, including almost all industry, oppose ESAs **fully funded by the industry**. They argued such a shift risks ESAs' accountability towards the Parliament. Others justify EU/public funding with the argument that the whole economy and society benefit from effective supervision.

A majority of respondents, including industry association and public authorities, also oppose a system **partly funded by the industry**. Many of them put forward the same arguments as on the question of a fully industry-funded system. EBA would strongly welcome a change to its funding. A few stakeholders, including few industry representatives, some companies and a few public authorities, favour a system partly funded by the industry.

Views are fairly balanced on the question of the funding allocation methodology. The majority of respondents favour a contribution to the cost of ESAs' activities based on the size of each sector and of the entities operating within each sector because this would be fair distribution of costs. On the other hand, many stakeholders supported a contribution which reflects the size of each Member State's financial industry, mainly because in a single market there is no rationale to adopt allocation methodology based on QMV rules. Some think tanks point out that such finding methodology is the only possible way to take into account market specificities of each country.

The arguments used to support allocation methodology based on QMV rules are efficiency, legal simplicity, predictability and stability of fee collection. A few respondents point the need of adapting the voting weight of the Member to ESAs funding allocation methodology.

Views are divided as to the exact metrics to be used in determining Member States' contributions. Bank representatives favour using total assets under the scope of the ESAs, combined with some kind of risk measurement, as a proxy of the market share. Audit and accounting representatives support the use of risk related indicators only. Market infrastructure representatives favour a revenue-based or a total assets approach.

Most industry stakeholders argue that the respective national CA should collect the contribution on behalf of the ESA in order to use existing funding models and avoid a new direct collecting relationship of ESAs with industry. Some recall that almost all national CAs have appropriate mechanisms in place to pass on this cost to the industry. Many stakeholders warn that a double charge for the industry should be avoided. Several public and private sector stakeholders underline the need to respect the proportionality principle. Several stakeholders underline the particular case of Institutions for Occupational Retirement Provision (IORPs) which are not-profit organisations, which is why they should not contribute or contribute to a lesser extent.

The degree of harmonisation of the **collection methodology** is considered potentially problematic due to differences between existing national structures or because harmonised fee collection would exacerbate distortions of competition. Several industry representatives call for a thorough coordination with the industry. Non-governmental organisations argue that the sources and channels of funding should not influence the ESAs' independence and supranational orientation.

### **11.3 Who is affected by the initiative and how**

The present Impact Assessment considers more specific impacts on various entities more directly concerned by the review of the ESAs. These impacts are linked with the changes in the funding mechanism, the specific powers and the governance structures of the ESAs. The concerned institutions include the national CAs and the ESAs. The impact on supervised entities is also worth to be mentioned. Finally, the amendments in the funding regime, the powers and the governance structure of the ESAs will also involve other stakeholders, such as consumers and employees of companies in the financial services sector.

#### ***The national competent authorities (national CAs)***

The ESFS has been designed to ensure effective harmonisation of financial supervision in the EU. Moreover, the ESAs activities contribute to achieving supervisory level playing field across the Single Market.

While the national CAs will continue to be present at the Board of Supervisors which will remain the ultimate decision making forum on strategic matters, the preferred options for funding mechanism and governance of the ESAs will have an impact on the national CAs standing vis-à-vis the ESAs. First, the national CAs will be released from their obligation to contribute to the ESAs budget. Instead they will have a new obligation to collect the contributions from the supervised entities under their jurisdictions. Second, some of the changes in the governance structure and setting up of the executive board with decision making powers in specific areas of supervisory convergence will limit the role of the national CAs in areas where genuine European interests emerge.

#### ***The ESAs***

The preferred options in the present IA in all sections concern directly the ESAs, the way they are funded, their governance model and their powers.

The changes in the funding model of the ESAs will also have a direct impact on them. The shift to a funding model which combines contributions from the EU budget and the industry will keep the existent level of accountability and budget control while bringing more flexibility of the ESAs to fully meet their needs. Market participants in each Member State will contribute based on the size of the relevant sectors in their Member State.

With regards to the governance model will gain more independence and enhance the protection of the European interests, *inter alia* by introducing permanent members in the Boards. The preferred option will increase and improve supervisory convergence work and it should lead to a swifter and more EU oriented decision making in line with the ESAs;' mandate.

The targeted amendments of powers will improve the supervisory convergence work (peer reviews, mediation panels, and supervisory colleges). The ESAs will have power to access data directly from market participants and enforcement powers to ensure compliance. Furthermore, the ESAs will have a more clearly delineated role in the equivalence ex-post-monitoring and compliance work.

### ***Market participants***

The reform of the ESAs will have twofold impact on the market participants. First, the reformed ESAs will be able to perform more effectively on their mandates which will bring additional benefits for these stakeholders. For large financial groups, the improved cross-border and cross-sector supervision will reduce compliance costs thanks to harmonised standards and supervisory practices and will also potentially prevent failures and bankruptcies.

Introducing the mixt model of funding will create obligation for those that financially contribute to the ESAs budget. This is based on the logic that budget contributions from undertakings concerned to the ESAs are justified by the consideration that those undertakings should bear the cost arising out of the nature of their activities. Besides, some administrative burden may be caused to companies by possible adaptations of national systems on collecting the industry contributions. On the other hand, companies may be subject to additional reporting requirements, linked with the ESAs' direct power to access data.

### ***Other stakeholders***

The review of the ESAs will bring general benefits to various stakeholder groups in Europe, in particular the users of financial services. A better organised and functioning supervision will help the EU financial sector regain its role in the economy: to channel savings into most productive investments, and thus support the economic growth. More specifically, the benefits will above all be linked with the increased confidence of consumers, investors and entrepreneurs resulting from the enhanced financial stability in the Internal Market. The reviewed supervisory system will also provide better protection to users of financial services, including through greater convergence of conduct-of-business supervision. It will also facilitate access to finance by strengthening the resilience and preventing failure of individual financial institutions. The role of the stakeholders groups into the decision making process of the ESAs will be enhanced, in particular in the area of budget determination.

## 11.4 Funding

### 11.4.1 Comparison of EU texts within the scope of the ESA's remits (2010 versus 2017)<sup>118</sup>

ESMA	EU texts within the scope of ESMA's remits under Article 1(2) of the Founding Regulations (2009)	EU texts within the scope of the ESMA's remits in 2017
<b>Core texts</b>	<ul style="list-style-type: none"> <li>• Directive 97/9/EC on Investor-Compensation Schemes</li> <li>• Directive 98/26/EC on settlement finality in payment and securities settlement systems</li> <li>• Directive 2001/34/EC on the admission of securities to official stock exchange</li> <li>• Directive 2002/47/EC on financial collateral arrangements</li> <li>• Directive 2003/6/EC on insider dealing and market manipulation (market abuse) , as amended by Directive 2008/26/EC, as regards the implementing powers conferred on the Commission <b>(4 level 2 measures including 4 IA)</b></li> <li>• Directive 2003/71/EC on the prospectus <b>(with implementing Regulation 809/2004)</b></li> <li>• Directive 2004/39/EC on markets in financial instruments (MiF) <b>(with 2 implementing measures: Implementing Directive 2006/73/EC2 and Implementing Regulation 1287/2006)</b></li> <li>• Directive 2004/109/EC on transparency requirements (amending Directive 2001/34/EC</li> </ul>	<ul style="list-style-type: none"> <li>• Directive 97/9/EC on Investor-Compensation Schemes</li> <li>• Directive 98/26/EC on settlement finality in payment and securities settlement systems</li> <li>• Directive 2001/34/EC on the admission of securities to official stock exchange</li> <li>• Directive 2002/47/EC on financial collateral arrangements</li> <li>• Regulation No 596/2014 on market abuse (MAR), <b>(19 level 2 measures, including 3 DA, 6 RTS, 1 IA and 8 ITS); 13 adopted; 6 non adopted</b></li> <li>• Directive 2014/57/EU on criminal sanctions for market abuse (CS MAD)</li> <li>• Directive 2003/71/EC on the prospectus (as amended by Directive 2010/73/EU, as amended by Directive 2013/50/EU, <b>(12 level 2 texts, including 5 DA, 5 IA and 2 RTS) 12 adopted</b></li> <li>• Directive 2014/65/EU on markets in financial instruments (MiFID II), <b>(31 level 2 measures, including 2 DA, 18 IA and 11 ITS) ; 21 adopted, 10 non adopted</b></li> </ul>

<sup>118</sup> For the level 1 legislation, the Table did not take into account some texts that partly fall under ESAs' competence, insofar as the provisions concerned apply to entities falling under their scope of action. In addition, for the level 1 legislation, some texts can fall into the scope action of two ESAs. In such a case, those texts are sometimes mentioned only for the ESA which plays the greater role according to this text. For the level 2 legislation, the tables give a picture of the number of texts adopted and to be adopted in May 2017. The number of texts adopted or to be adopted do not necessarily correspond to the number of ESAs empowerments under the level 1 legislation. In some occurrences, the number of level 2 texts adopted or to be adopted is higher than the number of empowerments because some modifying level 2 texts are under consideration. In some occurrences, the number of level 2 texts is lower than the number of empowerments because some adopted level 2 measures bundled different empowerments.

	<p>and as amended by Directive 2008/22/EC), including 1 DA (Commission Implementing Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of 2004/109/EC)</p> <ul style="list-style-type: none"> <li>• Directive 2009/65/EC – UCITS IV (with 5 implementing measure)</li> <li>• Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions</li> <li>• Alternative Investment Fund Managers Directive (Not adopted at the time where the Funding Regulation was adopted)</li> <li>• Regulation 1060/2009/EC on credit rating agencies</li> </ul>	<ul style="list-style-type: none"> <li>• Regulation 600/2014/EU on markets in financial instruments (MIFIR) (35 level 2 measures, including 2 DA, 16 RTS and 17 IA) ; 14 adopted, 21 non adopted</li> <li>• Directive 2004/109/EC "transparency" as amended by Directive 2013/50/EU (33 level 2 measures including 18 DA, 3 RTS, 8 IA and 4 ITS); 9 adopted; 24 non adopted</li> <li>• Directive 2009/65/EU (as amended by Directive 2014/91/EU UCITS V amended by as regards depositary functions, remuneration policies and sanctions) (7 level 2 texts, including 5 DA and 2 ITS) ; 6 adopted, 1 non adopted</li> <li>• Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions</li> <li>• Alternative Investment Fund Managers Directive 2011/61/EU, (as amended by Directive 2013.14/EU), (11 level 2 measures, including 5 DA, 3 RTS and 3 IA), 5 adopted, 6 non adopted</li> <li>• Regulation 1060/2009/EC on credit rating agencies (as modified by Regulation 462/2013 and Directive 2013/14/EU) as amended by Regulation 513/2011 and Regulation 462/2013) (21 level 2 measures, including 4 DA, 7 RTS, 10 IA), 19 adopted, 2 non adopted</li> <li>• Regulation 909/2014 on central securities depositories (CSDR), including 9 level 2 measures (including 2 DA, 4 RTS, 2 IA and 1 RTS) 6 adopted, 3 non adopted</li> <li>• Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR)(73 level 2 measures, including 7 DA, 20 RTS, 41 IA, 5 ITS); 47 adopted,</li> </ul>
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		<p><b>26 non adopted</b></p> <ul style="list-style-type: none"> <li>• Regulation 346/2013/EU on European social entrepreneurship funds, (2 level 2 measures including 1 ITS and 1 DA); 1 adopted, 1 non adopted</li> <li>• Regulation (EU) No 345/2013 on European venture capital funds, (2 level 2 measure, including 1 ITS and 1 DA); 1 adopted, 1 non adopted</li> <li>• Regulation 1286/2014/EU on key information documents for packaged retail and insurance-based investment products (PRIIPs), (3 level 2 measures including 2 DA and 1 RTS); 2 adopted, 1 non adopted</li> <li>• Regulation 2015/760/EU on European long-term investment funds,( 2 level 2 measures, i.e. 2 RTS); 2 non adopted</li> <li>• Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds,( 25 level 2 measures, including 4 IA, 8 DA, 10 RTS, 3 ITS); 1 adopted, 24 non adopted</li> <li>• Regulation (EU) N 236/2012 on Short Selling and certain aspects of credit default swaps (5 level 2 measures, including 1 DA, 2 RTS, 1 IA, 1 ITS); 4 adopted, 1 non adopted</li> <li>• Regulation (EU) 2015/2365 on transparency of securities financing transactions and of reuse, (13 level 2 measures, including 2 DA, 6 RTS, 2 IA and 3 ITS), 13 adopted</li> </ul>
Total:	<ul style="list-style-type: none"> <li>• 12 'level 1' texts</li> <li>• 13 'level 2 texts'</li> </ul>	<ul style="list-style-type: none"> <li>• 23 'level 1' texts</li> <li>• 303 'level 2' texts: 174 adopted, 129 non adopted</li> </ul>



EBA	EU texts within the scope of EBA's remits under Article 1(2) of the Founding Regulations (2009)	EU texts within the scope of the EBA's remits in 2017
Core texts	<ul style="list-style-type: none"> <li>• Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions</li> <li>• Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions</li> <li>• Directive 2002/87/EC — supervision of financial conglomerates</li> <li>• Regulation (EC) No 1781/2006 on information on the payer accompanying transfers of funds</li> <li>• Directive 94/19/EC on deposit-guarantee schemes, as amended by Directive 2009/14/EC</li> </ul>	<ul style="list-style-type: none"> <li>• Regulation (EU) No 575/2013 - CRR or Capital Requirements Regulation (with its Corrigendum 1, and Corrigendum 2), <b>(80 level 2 measures including 4 DA, 42 RTS, 11 IA, 23 ITS); 56 adopted, 24 non adopted</b></li> <li>• Directive 2013/36/EU, CRD IV or Capital Requirements Directive IV (with its Corrigendum 1), <b>(20 level 2 measures, including 11 RTS and 9 ITS), 17 adopted and 3 non adopted</b></li> <li>• Directive 2002/87/EC — supervision of financial conglomerates (notably amended by Directive 2011/89/EU)</li> <li>• Regulation (EC) No 1781/2006 on information on the payer accompanying transfers of funds</li> <li>• Directive 94/19/EC on deposit-guarantee schemes, as amended by Directive 2009/14/EC</li> <li>• Directive 2014/49/EU on deposit guarantee schemes, <b>including 1 level 2 measure, i.e. 1 DA, 1 non adopted</b></li> <li>• Directive 2014/59/EU (BRRD or the Bank Recovery and Resolution Directive), <b>(15 level 2 measures including 4 DA, 7 RTS and 4 ITS), 11 adopted, 4 non adopted</b></li> </ul>
Total	<ul style="list-style-type: none"> <li>• 5 'level 1 texts'</li> <li>• 0 'level 2' text</li> </ul>	<ul style="list-style-type: none"> <li>• 7 'level 1 texts'</li> <li>• 116 'level 2' texts : 84 adopted, 32 non adopted</li> </ul>

EIOPA	EU texts within the scope of EIOPA's remits under Article 1(2) of the Founding Regulations (2009)	EU texts within the scope of the EIOPA's remits in 2017
<b>Core texts</b>	<ul style="list-style-type: none"> <li>• Solvency II Directive 2009/138/EC</li> <li>• Directive 2002/92/EC on insurance mediation</li> <li>• Occupational Pension Funds Directive 2003/41/EC</li> <li>• Directive 2002/87/EC on financial conglomerates</li> <li>• Solvency I package (Directives 64/225/EEC, 73/239/EEC, 73/240/EEC, 76/580/EEC, 78/473/EEC, 84/641/EEC, 87/344/EEC, 88/357/EEC, 92/49/EEC, 98/78/EC, 2001/17/EC, 2002/83/EC and 2005/68/EC)<sup>119</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Solvency II Directive 2009/138/EC, <b>(47 level 2 measures, including 15 DA, 5 RTS, 6 IA and 21 ITS), 31 adopted, 16 non adopted</b></li> <li>• Directive 2002/92/EC on insurance mediation</li> <li>• Occupational Pension Funds Directive 2003/41/EC (IORP I)</li> <li>• Directive 2016/2341 EU Institutions for Occupational Retirement Provision Directive (IORP II)</li> <li>• Directive 2002/87/EC on financial conglomerates</li> <li>• Insurance distribution - Directive 2016/97/EU, <b>(6 level 2 measure including 4 DA, 1 RTS, 1 ITS), 6 non adopted</b></li> <li>• Regulation 1286/2014/EU on key information documents for packaged retail and insurance-based investment products (PRIIPs), <b>( 3 level 2 measures including 2 DA and 1 RTS), 2 adopted, 1 non adopted</b></li> </ul>
Total	5 'level 1 texts' and 0 'level 2' text	<ul style="list-style-type: none"> <li>• 7 'level 1 texts'</li> <li>• 56 'level 2' texts: 33 adopted, 23 non adopted</li> </ul>

### 11.4.2 Simulations for Option 2

Adjusting the MS contributions according to the size of their respective financial market (measured by a measure of value added by the financial sector; produced by Eurostat), would result to the following (adjusted) allocations:

<sup>119</sup> The Solvency I 'Package' is considered as a unique legislative framework for this Table.

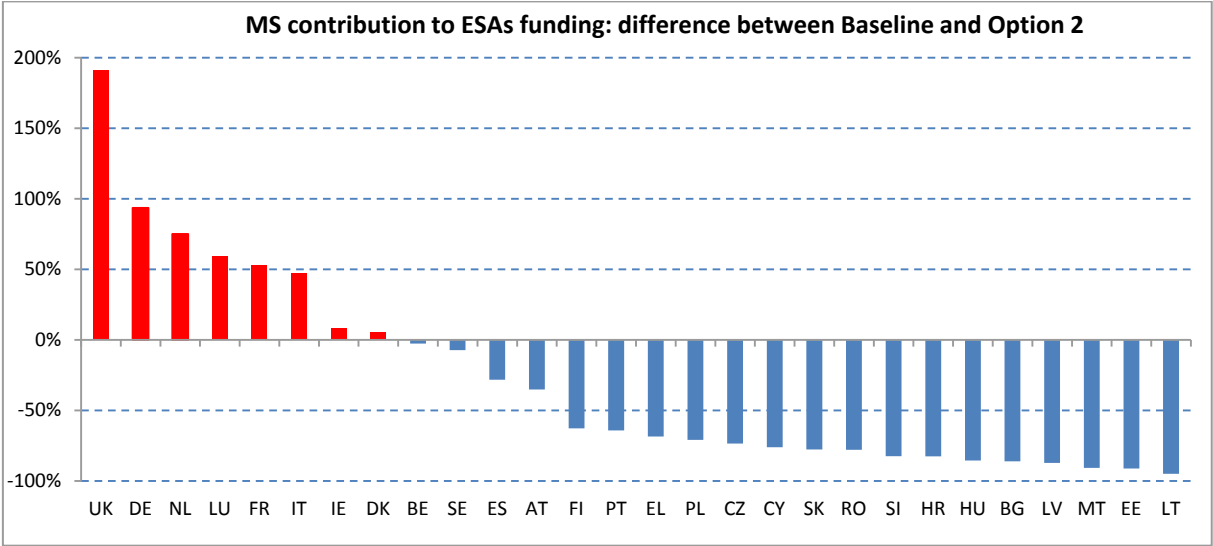
**Table 1**

Country	Adjusted MS key (%)	Baseline (%)
UK	23.95	8.24
Germany	15.94	8.24
France	12.56	8.24
Italy	12.11	8.24
Netherlands	6.46	3.69
Spain	5.50	7.67
Belgium	3.32	3.41
Sweden	2.63	2.84
Poland	2.23	7.67
Ireland	2.15	1.99
Denmark	2.09	1.99
Austria	1.84	2.84
Luxembourg	1.81	1.14
Portugal	1.22	3.41
Greece	1.07	3.41
Czech Republic	0.90	3.41
Romania	0.88	3.98
Finland	0.74	1.99
Hungary	0.49	3.41
Slovakia	0.44	1.99
Bulgaria	0.39	2.84
Croatia	0.35	1.99
Cyprus	0.27	1.14
Slovenia	0.20	1.14
Latvia	0.15	1.14
Lithuania	0.10	1.99
Estonia	0.10	1.14
Malta	0.08	0.85

Source: Eurostat

Figure 1 illustrates the difference in MS contributions to ESAs funding between the Baseline and Option 2.

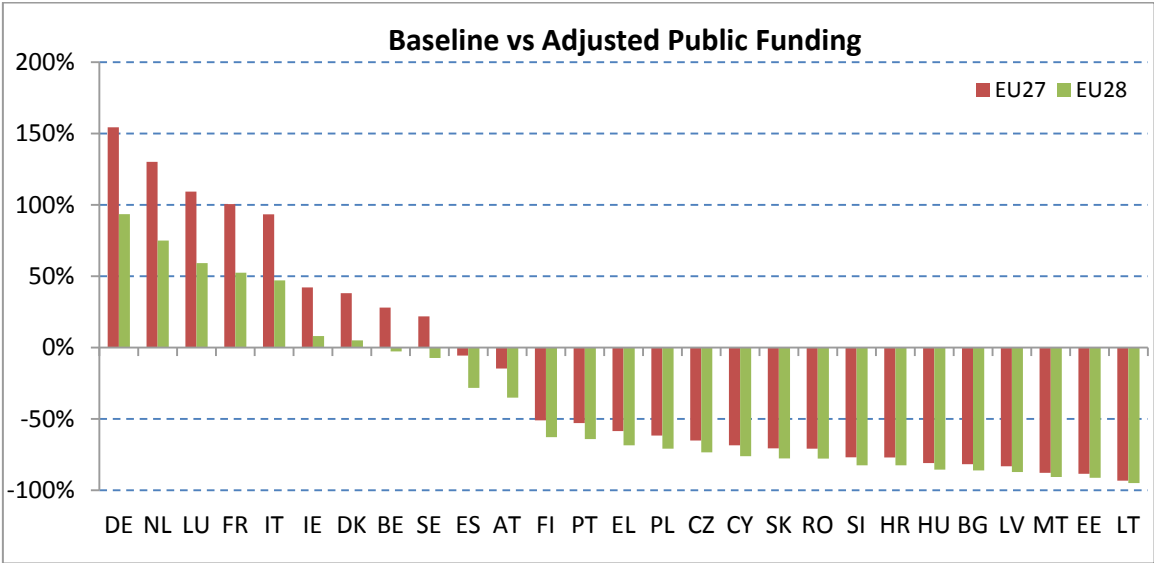
**Figure 1**



Source: Eurostat and European Commission

Figure 2 shows the difference in MS contributions to ESAs funding under the EU28 and the EU27 scenarios.

**Figure 2**



Source: Eurostat and European Commission

**11.4.3 Simulations for the allocation of private sector contributions across the financial industry (Options 3 & 4)**

Options 3 & 4 would involve implementing a methodology for the calculation of fees based on services provided by ESAs to each financial sector under their supervisory remit.

For the purpose of these simulations, sectors may be defined according to types of constituents covered in the sectoral legislation under each ESAs remit. For example, for EBA, the main constituents are (a) credit institutions, (b) investment firms, (c) payment institutions and (d) electronic money institutions. Other entities are also covered by EBA activities such as mortgage creditors which are not credit institutions, payment card schemes, processing entities or ‘bureaux de change’. There are other constituents in the scope of the EBA such as public bodies, BRRD holding companies, insurance intermediaries, ECAIs, CRAs or financial holding companies but they are only incidental to the core business of the EBA.

In the case of ESMA, the main constituents are (a) Investment Management Companies (covering Alternative Investment Fund Managers, European Social Entrepreneurship Funds, European Venture Capital Funds, European Long-term Investment Funds (ELTIFs), Undertakings for Collective Investment in Transferable Securities Directive (UCITS)), (b) investment firms, (c) Markets Infrastructures (such as MTF, Regulated Markets, Systematic Internalisers, CCPs, CSDs, Benchmark administrators) and (d) issuers.

For EIOPA, the main constituents are (a) Insurance undertakings and (b) Institutions for Occupational Retirement Funds (IOPRS).

According to ESAs, there are currently 2,666 insurance undertakings and 1,573 IORPS under EIOPA's remit; 2,500 Investment management companies, 8,250 Investment firms, 350 Market infrastructures (such as CCPs, stock exchanges, systemic internalisers, trade repositories and MTFs), 45 CRAs and 10000 issuers under ESMA's remit; and 5,665 Credit institutions, 5,934 Investment firms and 2,500 Authorised payment institutions and electronic money institutions under EBA's remit.

## Methodology

Based on their Annual Work Program, ESAs can identify those products and services specifically allocated to their sectoral work (e.g. Level 2 measures preparation, peer reviews, consumer protection, financial innovation, risk monitoring etc.). Based on this identification ESAs can determine the cost per activity in terms of specific staffing costs<sup>120</sup>, fixed and operational<sup>121</sup> costs. Using their existing Budgeting IT systems, ESAs could allocate these resources to sectors. In a subsequent stage, fee allocation to entities could be further elaborated using appropriate distributional keys.

The following simulations show how this methodology could be applied. The percentage of activity to a given sector has been provided as a preliminary estimation by ESAs based on their latest annual work programmes.

**Simulation 1:** *Percentage of activity allocated to sectors based on their 2018 estimated budget – an EIOPA example assuming full private funding (i.e. maximum possible contribution from private sector)*

Sector within EIOPAs remit	% activity in year 2017	Estimated Budget allocation	Estimated No. entities	Average fee per entity	Indicative Distribution key
Insurance undertakings	85%	21,6M€	2,666	8,102€	Gross written premiums

<sup>120</sup> Specific staffing costs involved data to the level of the proportion of each member of staff who it is planned will work on the activity. By using averages based on contract, training and other staffing costs it was possible to establish reasonably accurately the staffing costs for the activity. A similar principle was applied to fixed costs such as rent.

<sup>121</sup> According to EIOPA, each activity may also have operational costs assigned, which are allocated based on pre-defined and agreed need. For example, if an activity requires the procurement of a new software package, a request is defined within their initial plans. Once approved, it is included in the budget and plan, with records maintained on where the demand originates so that it is possible, for management purposes, to keep track and report on the data.

Institutions for Occupational Retirement Funds (Pension Funds)*	15%	3.8M€	1,573 <sup>122</sup>	2,415€	Total assets
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\*According to EIOPA's register

**Simulation 2:** *Percentage of activity allocated to sectors based on their 2018 estimated budget – an ESMA example assuming full private funding*

Sector within ESMA's remit	% activity in year 2018	Estimated Budget allocation	Estimated No. entities	Average fee per entity	Indicative Distribution key
Investment management companies	5%	2.1M€	2,500	840€	Assets under management
Investment firms	21%	8.7M€	8,250	1,050€	Turnover
Market infrastructures	24%	10M€	350	28,600€	Turnover
CRAs	33%	13.7M€	45	304,000€	Turnover
Issuers	17%	7.2M€	10,000	720€	Market Capitalisation

<sup>122</sup> Data for 19 EU countries as GR, IE, RO and UK haven't provide relative info on EIOPA's register

**Simulation 3:** *Percentage of activity allocated to sectors based on their 2018 estimated budget – an EBA example assuming full private funding*

Sector within EBAs remit	% activity in year 2017	Estimated Budget allocation	Estimated No. entities	Average fee per entity	Indicative Distribution key
Credit institutions	83%	34,8M€	5,665	6,778€	Total assets
Investment firms under EBA's remit	9%	3,8M€	5,934	640€	Turnover
Authorised payment institutions and electronic money institutions	8%	3,3M€	2,500	1,320€	Turnover

**11.4.4 Overview of costs of preferred options**

Overview of costs (overheads excluded)– Preferred options						
Indicative costs of indirect supervision (ESAs core financing) and new direct supervisory powers for ESMA						
	Citizens/Consumers		Businesses		Administration (ESAs)	
	One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
<b>Costs of indirect supervision (ESAs core financing – per ESA)</b>	No costs involved for citizens/consumers	Entities <b>indirectly supervised</b> by the ESAs will pay a contribution which should be waived from their current national CA contribution. Entities will not be charged twice for ESAs indirect supervision.  Considering the high population of entities that will be indirectly supervised (more than 20,000 for ESMA, 10,000 for EBA and 4,000 for EIOPA), the total amount to be distributed will	IT cost estimated at EUR 500,000 for ESMA.		See estimations below on contributions collection The changes in the governance structure and indirect supervisory powers of the ESAs could imply additional human resources estimated at 9 FTEs and respectively for EIOPA, ESMA and EBA, 19, 25 and 15	



		<p>result in individual contributions (per head count) ranging (under the 2016 budget) between EUR338 and EUR16,457 (value at 60% coverage of total budget) Weighted average = EUR1,301</p> <p>Indicative simulations on contributions to entities are provided in Annex 11.4. 3. under the extreme scenario of 100% industry funding or total share to be funded by the industry at approximately 100m euros.</p> <p>The net impact to various stakeholders is discussed in sections 8.4.2 and 8.4.3.2.</p>		<p>FTEs.</p> <p>Translation costs at EUR 200,000 for EIOPA and EBA, EUR 1,000,000 for ESMA. IT cost at EUR 100,000 for ESMA.</p>
<b>Collection of contributions by the industry (via NCAs)</b>	No costs involved for citizens/consumers	No direct costs involved.	<p>IT costs: EUR 1,000,000 one-off costs</p> <p>Collection systems will be further impact assessed in the delegated act, mentioned on p.[78] of the IA</p>	<p>EUR 200,000 euros and 5 FTEs</p> <p>Collection systems will be further assessed in the delegated act as discussed in p.[78] of the IA</p>
<b>New direct supervisory powers for ESMA and resulting costs</b>	No costs involved for citizens/consumers	<p>For existing entities, any shift of direct supervisory powers for ESMA will generate recurring fees for doing business similar to those paid to national CAs. The net impact should be therefore neutral. In areas where direct powers do not exist at national level (e.g. benchmarks) entities under direct supervision will bear a new cost to be established according to the population of entities (for which we do not have data).</p> <p>For direct supervision, fee allocation, fee levels and relevant modalities have been always defined in a delegated regulation. This was the case for Credit rating agencies (see COM</p>	<p>IT costs for EUR 3,000,000 (EUR 2,000,000 for data management in the supervision of data service providers and EUR 500,000 each for EU-labelled funds data management and prospectuses data management)</p>	<p>Based on experience of national CAs, it can be estimated that about 32 FTEs are needed for prospectus approval. 6 FTE would be necessary to supervise about 120 European investment funds. Resources for benchmark supervision can be estimated at 6 FTEs. Supervision of data reporting services providers may require 22 additional FTEs. 4 FTEs for the collection mechanism and funding.</p>

		delegated regulation 272/2012 and Trade repositories (COM delegated regulation 1003/2013) Current directly supervised entities pay depending on the size of their activities.		To these estimates overheads need to be added (typically in the range of 10% to 20%) in the form of lawyers accountants and other specialist support. Such an increase in head counts may also require a considerable extension of ESMA's office space and office and IT equipment.
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## 11.5 Evaluation of the ESAs operations

### Section 1 Executive Summary

With a view to safeguarding, financial stability, adequate investor/consumer protection and market integrity, the EU internal market for financial services requires common rules and strong regulatory and supervisory convergence among the Member States. When the EU overhauled the regulatory and supervisory framework for its financial system in response to the financial crisis of 2008/9, in line with global efforts, it introduced a Single Rulebook for financial regulation in Europe and created the European Supervisory Authorities ("ESAs") as part of the European System of Financial Supervision ("EFSF") to help in developing and implementing those single rules. To this end, the ESAs' must also address potential cross-border frictions within the internal market by promoting regulatory and supervisory convergence. In meeting these various objectives, the ESAs constitute an "institutional cornerstone" of the comprehensive EU financial-sector reform package put in place in recent years.

This report evaluates the functioning of the ESAs in the context of the Commission's review of the EFSF and also responds to the requirements for an evaluation report set out in Article 81 of the ESAs' founding regulations. The evaluation focuses on the effectiveness, efficiency, relevance, coherence and added value of the ESAs in pursuing their objectives, and to recommend ways to improve the framework within the ESAs operate in light of future challenges. The scope of the report is limited to EU framework for micro-prudential supervision (and so does not cover the EU framework for macro-prudential supervision and the functioning of the European Systemic Risk Board).

The evaluation finds that the ESAs have broadly delivered on their objectives. They have contributed significantly to development and implementation of the Single Rulebook by (a) providing essential technical advice to the Commission in the preparation of its proposals for primary legislation and (b) making an important technical contribution in the adoption of

secondary legislation. In this context, they have managed a very heavy regulatory workload (e.g. preparation of more than 40 pieces of primary legislation and hundreds of regulatory technical standards), delivering high-quality output generally within tight specified deadlines. The ESAs have also contributed to advancing regulatory and supervisory convergence among the Member States, identifying and addressing potential cross-border friction in implementation of the single rules. However, progress in the area of convergence has been constrained by limitations in the powers of the ESA to resolve differences in implementation of rules among national authorities (e.g. reliance on non-binding guidelines). Furthermore, the ESAs' powers have been rendered less effective by challenges related to their governance structure, whereby the absence of a more centralised decision-making process has made it more difficult to manage conflicts of interest within the ESA Boards. These governance challenges have been reflected in significant delays in making decisions and sometimes no decisions at all. In terms of funding arrangements for the ESAs, the evaluation reveals that the current framework is unlikely to ensure, in a sustainable way, sufficient financial resources to enable the ESAs to operate effectively and carry out the tasks that they will be required to fulfil as financial markets – notably in the context of Capital Markets Union (CMU) - become progressively more integrated both within the EU and between the EU and the rest of the world. Finally, the evaluation shows that the current sector-based architecture for the ESAs has worked well and remains appropriate. Other potential architectures are conceivable (e.g. a so-called twin-peaks model in which supervision of banking and insurance is merged into one institution) and have been analysed extensively in academic literature. However, this analysis is inconclusive and there is no evidence arising from the evaluation to indicate that a change in the existing ESAs architecture would yield significant benefits in terms of meeting their objectives.

On the above basis, the evaluation concludes that, while the functioning of the ESAs has been coherent, relevant and has delivered added value, there is scope for improvement with a view to increasing the effectiveness, efficiency and sustainability of the ESA framework in the context of more integrated financial markets within the EU and between the EU and the rest of the world. Such improvements relate to (a) powers, which could be enhanced in targeted ways to enable them to better perform their tasks in assuring necessary regulatory and supervisory convergence among the Member States; (b) governance, which could be improved to facilitate decision-making by better managing conflicts of interests within the Boards of Supervisors; and (c) funding arrangements, which need to be made consistent with the enhanced role envisaged for the ESAs in future years. These conclusions form the basis for this impact assessment, which accompanies the Commission proposal to reinforce the ESAs framework.

## **Section 2 Introduction**

In response to the financial crisis of 2008/9, and in line with global efforts, the EU has overhauled the framework for financial regulation and supervision. This comprehensive package of reforms included the establishment of the European Supervisory Authorities

("ESAs"), which have played a key role in ensuring that the financial markets across the EU are functioning in an orderly manner and are well regulated and supervised.

Article 81 of the ESA Regulations mandates the European Commission ("Commission") to carry out a review of the operations of the ESAs in 2017 and to draft a review report accompanied by legislative proposals, if appropriate.<sup>123</sup> Additionally, the Commission's Work Programme for 2017 announces a review of the European System of Financial Supervision (ESFS) i.e. the system comprising the ESAs which are responsible for EU-level micro-prudential supervision and the European Systemic Risk Board (ESRB) which is responsible for EU-level macro-prudential supervision. In the context of these reviews, a stakeholder consultation on the functioning of the ESAs was undertaken during the spring of 2017.<sup>124</sup>

The Commission already carried out a first evaluation of the ESAs functioning in 2014. That evaluation concluded that the ESAs had performed well, but nonetheless the Commission identified a number of issues that could be considered for improvement. These improvements related broadly to (1) powers (e.g., an increased focus on supervisory convergence, more effective use of existing powers, and clarifications of and possible extensions to current mandates); (2) governance (e.g., enhanced internal governance to ensure that decisions are taken in the interest of the EU as a whole); (3) funding framework (replacing the current framework); and (4) supervisory architecture (assessment of structural changes such as merging the authorities into a single body and seat or introducing a twin-peaks approach).<sup>125</sup> These four categories broadly correspond to the areas listed for review in Article 81 of the ESA Regulations. However, because the 2014 evaluation took place after a very short observation period (after less than three years of operation)<sup>126</sup> and because the regulatory and supervisory environment was still uncertain,<sup>127</sup> the Commission considered it premature to propose legislative changes at that point in time.

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<sup>123</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, page 12; Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, 48; and Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, page 84.

<sup>124</sup> For the macro-prudential leg of the ESFS, see the consultation that was published in August 2016 and the following summary report published in December 2016.

<sup>125</sup> Other recommendations include: direct access to data when necessary; possible strengthening of dispute settlement powers and further assessment of possible structural changes including a single location for the ESAs and extended direct supervision powers.

<sup>126</sup> Recognised by virtually all stakeholders, including the Commission and Parliament.

<sup>127</sup> The evaluation was carried out pending negotiations and the entry into force of revised sectoral legislation and of the establishment of the Single Supervisory Mechanism, the Single Resolution Mechanism and the Single Resolution Board.

In October 2013, the European Parliament ("Parliament") had conducted a review of the ESAs.<sup>128</sup> Some of the conclusions were similar to those of the Commission in terms of the performance of the ESAs, notably including the fact that the observation period was very short. The Parliament report contained a detailed list of items for improvement, some of which would require legislative changes. Additionally, in its March 2014 resolution on the ESFS review, the Parliament requested the Commission to submit new legislative proposals for the revision of the ESAs in areas including governance, representation, supervisory cooperation and convergence, and the enhancement of powers.<sup>129</sup>

The Council concluded in November 2014 that targeted adaptations should be considered in order to improve the ESAs performance, governance and financing.

While the broader scope for this second Commission evaluation is defined by Article 81 of the ESA Regulations, particular consideration has been given to issues raised in previous evaluations. Stakeholder claims (including those made in the context of the Commission's call for evidence and of the Capital Markets Union as well as in the 2017 stakeholder consultation dedicated to the operations of the ESAs<sup>130</sup>) are also taken into account. The scope of the evaluation does not cover macro-prudential oversight. This is because the review of the EU macro-prudential framework started much earlier than the review of the ESFS was announced in the Commission's work programme and also before work on the ESA framework started. The review of the macro-prudential framework is, therefore, developed separately but is nevertheless related to the ESAs review. Accordingly, due account has been taken of the work carried out within the context of the EU's macro-prudential framework, especially in relation to the coordination of micro- and macro-prudential policy. Any legislative proposals on the ESAs will be put forward together with proposals that follow on the review of the European Systemic Risk Board ("ESRB").

The functioning of the ESAs has been evaluated against their general objectives to enhance consumer and investor protection and sustainably reinforce the stability and effectiveness of the financial system throughout the EU.<sup>131</sup> In line with Better Regulation principles, the effectiveness, efficiency, coherence, relevance and EU added value of the ESAs' operations have been assessed.<sup>132</sup> As a result of the conclusions made in this evaluation, the Commission will put forward a proposal for legislative amendments to the ESA Regulations. The results of this evaluation have consequently also informed the problem definition of the impact assessment to which this evaluation is annexed.

### Section 3 Background to the initiative

<sup>128</sup> See the report published in October 2013 by the Parliament on the ESAs and the ESFS: Review of the New European System of Financial Supervision (ESFS), IP/A/ECON/ST/2012-23, October 2013.

<sup>129</sup> European Parliament resolution of 11 March 2014 with recommendations to the Commission on the European System of Financial Supervision (ESFS) Review (2013/2166(INL)).

<sup>130</sup> For a synopsis report on the latter, see Annex 11.2

<sup>131</sup> See Article 1(5) of the ESA Regulations.

<sup>132</sup> See chapter VI (page 56) of the Better Regulation Guidelines.

### Description of the situation before the creation of the ESAs

Before the creation of the ESAs, the system of micro-prudential supervision in the EU was predominantly nationally based; i.e. it was based on the principle of home-country control combined with minimum prudential standards and mutual recognition. Under this system a financial institution was authorised and supervised in its home-country and could expand throughout the EU either by:

(a) offering cross-border services in other EU Member States or establishing branches in those States without additional supervision (i.e. the host country was required to recognise supervision from the home-country authorities on most prudential issues); or

(b) more typically, financial institutions have chosen to operate through subsidiaries (separate legal entities) in the host countries. Those subsidiaries have to be separately licensed and supervised by the host country authorities. However, in practice the scope for control by host countries of these subsidiaries is limited as key decisions are often taken by the parent company in the home country and the financial health of the subsidiary is closely linked to the well-being of the financial group as a whole. The primary effective control of large financial groups as a whole was (and is) therefore essentially in the hands of the group consolidated supervisor in the home country.

Irrespective of how cross-border banking is provided, there is a need for close cooperation among national supervisors. Before the ESAs, cooperation among national supervisory authorities took place mainly through the following framework:

- the three “Level 3 Lamfalussy Committees of Supervisors” (i.e. the Committee of European Banking Supervisors (“CEBS”), Committee of Insurance and Occupational Pension Supervisors (“CEIOPS”) and the Committee of European Securities Regulators (“CESR”)) that were established between 2001 and 2004. Those Committees had been established to ensure supervisory convergence, to facilitate agreement on common application of EU rules and to help build mutual trust among supervisors. Those Committees were from an institutional perspective part of the Commission, but had no regulatory or executive powers and acted on the basis of consensus or in some cases qualified majority voting. They were originally funded by the Member States as members of the Committees and contributions were based on the number of votes held in Council. At one point, they began to receive contributions from the EU Budget;
- via meetings of national authorities within the Council;
- colleges of supervisors that at the time were just in their infancy and focused on the larger financial institutions in the EU; and
- *ad hoc* bilateral Memoranda of Understanding between national supervisory authorities.

Experience of the financial crisis exposed important failings in the existing framework for financial supervision, both in particular cases (micro-prudential) and in relation to the

financial system as a whole (macro-prudential). The predominantly nationally-based supervisory arrangements proved inadequate to manage a crisis in the by-then highly integrated and interconnected financial markets within the EU. In particular, the crisis exposed important divergences among Member States in implementing the existing rules. Thus, in addition to overhauling the pre-crisis EU regulatory framework, there was an urgent need to address serious failings in the cooperation, coordination and consistency of national supervisors in implementing the new post-crisis regulatory framework. These problems were not confined to the EU and, at the same time, there were calls to build a stronger, more consistent, regulatory and supervisory system for the global financial system within the G20 framework.<sup>133</sup>

In November 2008, the Commission mandated a High Level Group chaired by Mr Jacques de Larosière to propose recommendations to the Commission on how to strengthen European supervisory arrangements. The de Larosière group presented its vision for a new system of European financial supervision in February 2009. At the core of this vision was a proposal to create the ESAs, so as to strengthen coordination and cooperation among national supervisors. The group considered that the then existing co-operation mechanisms did not have the potential to correct the most serious inefficiencies in cross-border supervision. In particular, the de Larosière Group highlighted the fact that supervisors could not take binding decisions at the EU level. This meant that national supervisors were taking decisions on the basis of domestic considerations, even when the problems at hand had a significant EU dimension and would require coordinated decisions and actions in order to achieve the best possible outcome for all.

Building on the recommendations made by the de Larosière group, the Commission issued a Communication in May 2009 setting out the basic architecture for a new European financial supervisory framework.<sup>134</sup> The Commission proposed that the new financial supervisory system (EFSF) be composed of two pillars. The first pillar would consist of a body that would monitor and assess potential threats to financial stability that arise from macro-economic developments and from developments within the financial system as a whole (which is now the ESRB). The second pillar would consist of a network of national financial supervisors working in tandem with EU level supervisory authorities (now the ESAs) to safeguard financial soundness at the level of individual financial institutions and protect consumers of financial services (micro-prudential supervision). On micro-prudential supervision it was more specifically proposed that the ESAs take over the role of the Committees of Supervisors but with a broadened remit including a range of responsibilities of a regulatory as well as of a supervisory nature. The Communication was accompanied by an impact assessment.

The legislative proposals for creating the ESAs were also accompanied by an impact assessment, which identified several problems relating to the existing supervisory system: (I) an imbalance of interests of the home and host countries (resulting in a misalignment of

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<sup>133</sup> See the London Summit Statement of April 2 2009.

<sup>134</sup> See the Communication from the Commission *European financial supervision*, Brussels 27.5.2009, COM(2009) 252 final.

incentives in particular in cross-border crisis management); (2) risks of competitive distortions in the internal market and of regulatory arbitrage by financial institutions (arising in part from differing supervisory rules and practices); (3) insufficient co-operation and information exchange between national supervisors; and (4) excessive costs and administrative burden to cross-border companies due to fragmented and inconsistent financial supervision.

The European Banking Authority ("EBA"), the European Insurance and Occupational Pensions Authority ("EIOPA") and the European Securities and Markets Authority ("ESMA") – collectively the ESAs - were established early 2011 to address these problems. Compared to the Committees of Supervisors they were granted additional powers to ensure a more effective and coherent supervision across the EU, their organization and structure was modified to incentivize that powers be used in an appropriate manner, and a funding framework was developed to ensure that the ESAs' resources would be stable and allow them to operate effectively and efficiently and with independence.

### Description of the ESAs

The ESAs began operating as independent EU agencies in January 2011. The regulatory tasks of the ESAs relate to the development of the Single Rulebook and include providing technical advice to the Commission on Level 1 and Level 2 rules and, in the case of Level 2 rules in the form of Binding Technical Standards, providing the Commission with proposals for such rules. The ESAs also adopt guidelines and recommendations addressed to national competent authorities (NCAs) or financial institutions.

Broadly speaking, the ESAs supervisory powers are intended to support the pan-EU supervisory convergence and co-ordination. These include peer review powers as well as powers to mediate between NCAs where conflicts arise. When an emergency situation is declared by the Council, the ESAs have enhanced powers to coordinate Member States' responses and, if necessary, make binding decisions on CAs or on individual financial institutions. ESMA also has direct supervisory powers over credit-rating agencies and trade repositories.<sup>135</sup>

The decision-making bodies of the ESAs are their respective Boards of Supervisors, chaired in each case by a permanent ESA chairperson. The voting members of the ESAs Boards of Supervisors are the heads (or alternates) of the relevant NCAs. The permanent ESA Chairperson and Executive Director do not have voting rights.

The ESAs are funded by contributions from NCAs and the EU Budget in a ratio of 60:40. In accordance with sectoral legislation, ESMA receives fees directly from credit rating agencies and trade repositories as a result of its direct supervisory responsibilities.

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<sup>135</sup> In accordance with the European Market Infrastructure Regulation (EMIR, Regulation (EU) No 648/2012), ESMA is responsible for the registration, withdrawal of registration and supervision of trade repositories; Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies, OJ L 146, 31.5.2013, p. 1–33



It is important to note that while the ESAs have responsibilities for micro-prudential supervision at EU level, day-to-day supervision is still conducted at national level (with the notable exception of the SSM for significant institutions and ESMA in relation to credit rating agencies and trade repositories).

### The objectives of the ESAs

The overall objective of the ESAs is to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system for the EU economy, its citizens and businesses. More specifically they should contribute to:

- a) improving the functioning of the internal market, including, in particular, a sound, effective and consistent level of regulation and supervision;
- b) ensuring the integrity, transparency, efficiency and orderly functioning of financial markets;
- c) strengthening international supervisory coordination;
- d) preventing regulatory arbitrage and promoting equal conditions of competition;
- e) ensuring that risks in their respective sectors are appropriately regulated and supervised; and
- f) enhancing consumer protection.

The **intervention logic** below provides an illustration of the creation of the ESAs, their objectives, how they were expected to work and what they were intended to achieve.

A coherent, efficient and effective EU level supervisory system that sustainably contributes to reinforcing the stability and effectiveness of the financial system throughout the EU

## Needs

s

## Specific Objectives

Enhancing consumer and investor protection

Promoting the integrity, transparency, efficiency and well-functioning of financial markets, and the robustness of market participants and infrastructures.

Improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision

Strengthening international supervisory coordination

Preventing regulatory arbitrage and promoting equal conditions of competition

Ensuring that risks in the respective sectors are appropriately regulated and supervised

## Inputs

Powers to contribute coherent, consistent and effective supervision across all EU Member States via all of the ESAs interventions, both legally binding and non-legally binding ones

A governance structure which ensures that powers are used in an appropriate manner

Funding levels that are sustainable and commensurate to what is necessary, operating efficiently, to effectively fulfil the ESAs objectives and tasks

## Outputs

s

### The ESFS and ESA Regulations

## Results

Greater oversight of risk to consumers, investors, markets and of financial

Completion of the Single Rulebook

Supervisory convergence

Closer cooperation and exchange of information among national supervisors

EU solutions to cross-border problems

## Impacts

Increased financial integration

Greater financial stability

More consumer and investor protection

### The baseline (before the adoption of the ESA Regulations)

The 2010 ESA Regulations were fundamental to the improved organization of the supervision of financial institutions and markets in the EU after the 2008/9 crisis. In their absence, the baseline scenario is one in which the EU would have continued to build on nationally based supervisory arrangements where the principle of home country control combined with minimum prudential standards and mutual recognition would prevail. In the baseline scenario, it would have been possible to continue relying on the existing Committees of Supervisors, which were merely advisory bodies to the Commission, and the colleges of supervisors. Decisions by the Committees of Supervisors were generally taken by consensus or qualified majority voting. Qualified majority voting for decision making would have helped to accelerate the process of convergence in the implementation of EU law. Moreover, if colleges of supervisors were up and running, co-operation and information exchange between national supervisory authorities should be functional.

The baseline would nevertheless have remained sub-optimal. The existing co-operation mechanisms would have been weak and would not have allowed supervisors to take binding decisions at EU level. National supervisors would have continued to take decisions predominantly on the basis of domestic considerations, even when the problems at hand had a European dimension and required coordinated decisions and actions in order to achieve the best possible outcome for all. The fact that many decisions would have required consensus would imply inaction biases, with home country authorities and host country authorities unable to agree. As national authorities would have a fiduciary responsibility to their national Parliaments/taxpayers, there would be no incentive for either home or host authorities to make decisions in the common interest of the EU. Such inaction bias at EU level – could easily result in conflicting actions at national level – and would be a very serious problem in the case of a banking group or bank that is systemically relevant in a host country. There could be spill-over effects across the EU financial system if that banking group is sufficiently large and interconnected. Such shortcomings in the supervisory framework would reflect problems both with the extent of EU-level supervisory powers and with the governance in decision-making linked to those powers.

Problems with supervisory powers and governance would also be reflected in the day-to-day functioning of the internal market. There would be a lack of consistent rules, powers and sanctions across Member States, mainly due to a lack of harmonisation in certain areas. Differences in supervisory practices, e.g., in areas where the host supervisor of a branch has supervisory discretion, or in cases where supervisors take different perspectives would also remain. As a consequence there not be a level playing field across the EU and financial actors could exploit loopholes and arbitrage opportunities, undermining the overall quality of prudential risk management.

The establishment of the ESAs was a major step forward in the formulation and implementation of the EU-level regulatory framework. The ESAs were provided with expanded powers, improved governance and increased funding relative to their predecessor Committees. These enhancements allowed the ESAs to provide the necessary support to the

Commission in undertaken an extensive reform of the EU financial sector following the crisis. The reform of the financial sector has implied more than 40 pieces of primary legislation and more than 400 pieces of secondary legislation – all of which have been put in place within tight deadlines. The ESAs have played a key role in providing technical advice to the Commission in primary legislation and in formulating technical standards at secondary level, all, of which required the ESAs to work in new areas and reach agreement on frequently difficult compromises. None of this would have been possible without the upgrading of the Supervisory Committees to the ESAs. Moreover, in the baseline scenario, it would have been difficult to even envisage the Banking Union or the CMU, which require a high degree of EU-level harmonization in regulatory requirements as well as in supervisory practices.

With the prospect of further financial integration within the EU (notably with the creation of the CMU) and between the EU and the rest of the world (both organically and in more discrete terms with BREXIT), the ESAs will face new challenges. Despite the improvements in EU level supervision implied by the establishment of the ESAs, it cannot be assumed that the current framework in which they function will be adequate to the task in the years to come. Hence, a comprehensive review of the ESAs framework is not only necessary under Article 81 of the founding regulations but is also timely in the context of likely developments in the EU and global financial systems.

#### **Section 4 Methodology**

This evaluation has been carried out in-house by the Commission services and covers the time period 2014 to 2016. No analytical models have been applied. It is based on desk research (document and literature review), and draws support from the stakeholder consultation on the ESAs' operations, as well as stakeholder consultations held within the context of the call for evidence and the CMU. Moreover, the evaluation builds on interviews and discussions with ESA staff, on written information provided by ESA staff, and on exchanges with Member States. The present evaluation also builds on the previous evaluations made by the Commission and the Parliament, on Parliament resolutions and on Council conclusions. It also takes into consideration Parliament discharge hearings during the relevant time period.

#### *Limitations – robustness of findings*

The present evaluation was conducted on a back-to-back basis with the impact assessment on the ESA Regulations and has been carried out under a significant time constraint. It is based primarily on information provided by ESA staff, information from ESA published documents and informal evidence in relation to areas such as the ESAs' governance and powers. The level of quantification in the analysis is substantially constrained by the availability of relevant data. With the exception of the analysis of the ESAs' funding framework, the evaluation is therefore chiefly based on a qualitative analysis, cross-checking information from different sources. Support for analysis in the evaluation has been sought in the various stakeholder consultations.

## Section 5 Implementation state of play

The ESAs became operational on January 1 2011 when the ESA Regulations became applicable. This section focuses on the state of play in the following four main areas under evaluation: (1) powers; (2) governance; (3) funding framework; and (4) supervisory architecture and seat.

### **Powers**

The ESAs derive their powers from the ESA Regulations. Sectoral legislation further develops when these powers can be used.<sup>136</sup> In case of direct supervisory responsibilities (CRAs and trade repositories), ESMA derive its powers directly from sectoral legislation.

The ESAs are tasked with a range of supervisory co-ordination and convergence tasks as well as with responsibilities of a regulatory nature. The latter mainly relate to development of the Single Rulebook and include providing technical advice to the Commission on Level 1 and Level 2 rules and, in the case of Level 2 rules in the form of Binding Technical Standards, providing the Commission with drafts of such rules. The ESAs' responsibilities also include the adoption of guidance in relation to NCAs. The ESAs are also conferred with a range of supervisory powers, to support convergence in pan-EU supervisory practice ("supervisory convergence"). These supervisory powers include developing draft technical standards (for adoption by the Commission) and issuing guidelines and recommendations. They also include the power to initiate peer reviews as well as powers to mediate between NCAs where conflicts arise. They also have certain product intervention powers.

When an emergency situation is declared by the Council the ESAs have enhanced powers to coordinate Member States' responses and, if necessary, make binding decisions on NCAs or on individual financial institutions. Similarly, the ESAs have a limited set of decision making powers in case of CAs incorrectly applying EU law. They also have a coordination function in this respect, which is exercised in the context of supervisory colleges.

Beyond their coordination role in emergency situations the ESAs are required to promote a coordinated Union response, particularly in adverse market conditions, by facilitating information exchange among authorities, determining the scope/reliability of information to be made available by national authorities and centralizing information received, notifying to the ESRB potential emergency situations, and by taking all appropriate action to facilitate action by national authorities. Finally, ESMA also has direct supervisory powers over credit rating agencies and trade repositories.

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<sup>136</sup> The term "sectoral legislation" is used in this report for regulations and directives regulating financial services and banking in the Union and to separate this body of legislation from the ESA Regulations which do not deal with the substance of financial services and banking.

## **Governance**

The Board of Supervisors, which is the main decision-making body of the ESA, consists of the Chairperson (appointed by the Board of Supervisors), the head of the national NCA in each Member State, and one representative each from the Commission, the ESRB, the other two ESAs, the EEA-EFTA States and the EFTA Surveillance Authority. The Boards of Supervisors give guidance to the work of the ESAs and are in charge of taking decisions in relation to all tasks and powers of the ESAs except in respect of internal staff policy, access to ESA internal documents and with regard to the appointment of Board of Appeal members.

The ESAs are to serve the common interests of the EU as a whole and decisions are to be taken in that spirit. As a general rule, the Board of Supervisors should take its decisions by simple majority in accordance with the principle where each member has one vote. However, for regulatory and implementing technical standards, guidelines and recommendations, for budgetary matters as well as in respect of requests by a Member State to reconsider a decision by the ESAs to temporarily prohibit or restrict certain financial activities, the rules of qualified majority voting apply as in the Council. Only the representatives of the 28 national NCAs can vote.

The Management Board is composed of the Chairperson and six members of the Board of Supervisors (i.e. NCAs). An Executive Director and a representative of the Commission participate as observers (except on budget matters where the Commission has a right to vote). The only formal tasks of the Management Board relate to internal administrative issues and making proposals in relation to the ESA's work programme and budget. There is great disparity in the task distribution between the Management Board and the Board of Supervisors.

The Chairpersons of the ESAs' Boards of Supervisors are appointed by the Board of Supervisors following an open selection process and a hearing before the Parliament. The Chairpersons' only formal tasks comprise the preparation of the work of the Boards and chairing the Board meetings. They do not have voting rights.

In order to ensure cross-sectoral consistency in their activities the ESAs coordinate closely through a Joint Committee and reach common positions where appropriate. More specifically, the Joint Committee coordinates the functions of the ESAs in relation to financial conglomerates and other cross-sectoral matters.

## **Stakeholder groups**

To ensure a structured dialogue with stakeholders, the ESA Regulations establish specialised stakeholder groups for each ESA. They are supposed to facilitate consultation with consumers, users and providers of financial services. Each stakeholder group is composed of experts on the sector in question, representing a broad scope of stakeholders including financial institutions, employees' representatives, consumers and users of financial services, representatives of SMEs and academics. Stakeholder group members are appointed by the ESAs Boards of Supervisors.

The stakeholder groups are consulted when developing draft technical standards, guidelines and recommendations and may also submit opinions and advice on their own initiative.

### **Funding framework**

As the ESAs were granted additional powers compared to the Committees of Supervisor it was recognized that they would require additional staff and hence that the budgetary needs of the ESAs would be greater than for the Committees. However, the mix of member and EU Budget contributions were maintained.

The ESA Regulations stipulate that the ESAs can be funded by obligatory contributions from the NCAs, by a subsidy from the Union and by any fees paid to the ESAs in the cases specified in the relevant instruments of Union law.<sup>137</sup> Currently, the ESAs' revenues are based on contributions from national NCAs (60 percent) and from the General EU Budget (40 percent). In addition, ESMA receives some of its funding from the private entities it directly supervises i.e., credit rating agencies and trade repositories.

The annual EU contribution to the ESAs' funding is decided within the framework of the Multiannual Financial Framework ("MFF"), and more specifically within that of a Commission Communication of 10 July 2013 on the programming of human and financial resources for decentralised agencies 2014-2020.<sup>138</sup> The MFF lays down the maximum annual amounts ("ceilings") which the EU may spend in different political fields over a period of at least five years. The Communication sets out precise figures for number of staff members and budgets for each EU agency for each year up to 2020. In principles, the ceilings set cannot be surpassed which means that there is no room for allocating funding for growth or to insufficiencies if that means the ceiling would have to be surpassed.<sup>139</sup>

The Member States' contributions are proportionate to their shares of votes under the Council qualified majority voting rule.

The ESAs use activity based budgeting for developing their annual draft budgets which means that there is a strong connection between their annual work programs and the estimation of resources. As the ESAs are recipients of EU Budget contributions, the EU's Framework Financial Regulation ("FFR")<sup>140</sup> is their main point of reference for the principles and procedures governing the establishment, implementation and control of their budgets. To that end they have adopted their own internal financial regulations that mirror the provisions of the FFR.

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<sup>137</sup> See Article 62 of the ESA Regulations.

<sup>138</sup> Communication from the Commission to the European Parliament and the Council of 10 July 2013 on the programming of human and financial resources for decentralised agencies 2014-2020, COM(2013)519

<sup>139</sup> In practice, however, adjustments may take place in emergency situations, e.g., in recent years for agencies working on migration and security.

<sup>140</sup> Commission Delegated Regulation (EU) No 1271/2013 of 30 September 2013 on the framework financial regulation for the bodies referred to in Article 208 of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council, OJ L 328, 7.12.2013, p. 42–68.

## **Supervisory architecture and seat**

The architecture of the ESAs mirrors the traditional sectoral breakdown of the financial industry (banking, insurance/pensions and securities). It is also a legacy inherited from their predecessors, the Committees of Supervisors which were also organized in a sectoral way. The current seat of each of the three ESAs is also a legacy of their predecessors that were already seated in London (banking), Paris (securities) and Frankfurt (insurance and pensions).

### **Section 6 Evaluation analysis**

The analysis in this section will address the effectiveness, the efficiency, the coherence, the relevance and the EU-added value of the ESAs, broadly corresponding to the criteria listed for review in Article 81 of the ESA Regulations. These evaluation criteria will be applied in analysing four aspects of the existing ESA framework: (1) powers; (2) governance; (3) funding framework; and (4) supervisory architecture and seat and based on the following sets of questions

#### **Powers**

##### Effectiveness and efficiency:

- Have the powers available to the ESAs allowed them to improve regulatory and supervisory convergence?,
- Has the composition of the Boards and the role of the Chairpersons impacted on the ability of the ESAs to use their powers effectively?
- Have the ESAs' powers allowed them to promote consumer and investor protection, ensure the proper application of EU law and more generally allowed them to ensure an effective EU level supervision?
- Have the powers available to the ESAs allowed them to deliver on their tasks and objectives in an efficient way?

#### **Governance**

##### Effectiveness and efficiency:

- Has the current governance structure impacted on the incentives of the ESAs to use their powers in a manner that allows the ESAs to improve supervisory convergence?
- Has the composition of the Boards and the role of the Chairpersons impacted on the effectiveness of the ESAs work, and more generally allowed them to take decisions in the interest of the EU as a whole?
- Has the current governance structure allowed the ESAs to take swift decisions in the interest of the EU as a whole?



## **Funding framework**

### Effectiveness and efficiency

- Has the current funding framework and funding levels been effective to what is necessary for the ESAs to fulfil their objectives and tasks?
- Has the current funding framework been efficient (in terms of sufficiency and sustainability) in ensuring that ESAs fulfil their objectives and tasks in the most effective way?

## **Supervisory architecture and seat**

### Effectiveness and efficiency

- Has the current sectoral model of supervision ensured the greatest possible effectiveness of supervision and thereby guaranteed adequate protection of depositors, policy-holders and investors and of financial stability within the EU?
- Has the current sectoral model of supervision with separate seats been able to ensure the greatest possible effectiveness of supervision in an efficient way, i.e. at least cost to supervised companies, supervisors and tax payers?

In addition, the analysis will address the following overarching questions

- To what extent has the ESAs' framework been coherent with other EU measures taken in response to the financial crisis to increase the financial integration process within the EU by improving both regulation and supervision of financial institutions and other market participants in the EU?
- Is the ESAs framework still relevant?
- What is the added value resulting from the ESAs' framework compared to what could be achieved by the Committees of Supervisors? To what extent do the issues addressed by the establishment of the ESAs continue to require action at EU level? What would be the most likely consequences of removing the ESAs and the framework within which they operate?

## **Evaluation of the effectiveness and efficiency of ESAs in using their powers**

### Regulatory tasks

In relation to their regulatory tasks, the ESAs have experienced a significant increase in responsibilities and workload. For example, in 2009 there were 15 pieces of primary legislation adopted by the Council and the Parliament with tasks foreseen for the ESAs (9 allocating tasks to ESMA and EBA and 7 allocating tasks to EIOPA). Today, the

corresponding numbers are 29 for ESMA, 16 for EBA and 9 for EIOPA.<sup>141</sup> This increase in tasks has also brought a significant number of additional empowerments for delegated and implementing acts which impact directly on ESAs annual work programmes.

Monitoring indicators provided by the ESAs confirm that they have been confronted with a very intensive workload both before and during the evaluation period.<sup>142</sup> Since 2009??, EBA has delivered a total of 144 technical standards, which represents 85% of those required to be developed. It has delivered a total of 71 non-binding guidelines recommendations supporting the implementation of the regulatory framework. The Commission has only rejected one technical standard from those submitted and intends to amend eight. With the exception of one technical standard, all of EIOPA's XX proposed technical standards have been adopted by the Commission. In addition, it has adopted 39 non-binding guidelines. Out of 152 required technical standards, ESMA has put forward 145 for adoption by the Commission. Out of those, nine technical standards (6%) were not endorsed, endorsed in part or endorsed with amendments by the Commission. In addition, ESMA has adopted more than 38 non-binding recommendations with several under consultation or in draft.

This clearly illustrates that over the past years the ESAs have been effective in accomplishing their regulatory tasks - both in terms of the number and the quality of deliverables - and have made a powerful contribution to the development of a Single Rulebook. This evaluation based on deliverables is consistent with publicly available reports about the ESA, with previous evaluations made by the Commission and Parliament and is supported by responses received in stakeholder consultations.

#### Convergence of supervisory actions and the consistent application of EU law

In relation to the powers to support pan-EU supervisory convergence and co-ordination, the Commission has assessed the work programs and the annual reports of the ESAs and notes that since 2015 supervisory convergence has been a key objective for the ESAs.<sup>143</sup> The ESAs have been actively engaged in developing supervisory handbooks, conducting peer reviews, participating in supervisory colleges, conducting thematic reviews, trainings, workshops, etc.<sup>144</sup>.

In relation to the use of practical tools, such as those mentioned above, the Commission notes an increase in effectiveness relative to the Commission's 2014 evaluation report. Monitoring

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<sup>141</sup> See Annex 11.4

<sup>142</sup> E.g., Single Rule Book of prudential requirements for banks capital, liquidity & leverage and stricter rules on remuneration and improved transparency ('CRD IV / CRR'), effective since December 2013 and January 2014, respectively; New European supervisory framework for insurers ('Omnibus II') effective, since March 2015; Directive 2014/49/EU on Deposit Guarantee Schemes, effective since July 2015; Mortgage Credit Directive 2014/17/EU, effective since March 2016.

<sup>143</sup> ESMA/2015/935, 15.06.2015; EIOPA Multi-annual work programme 2015-2017, EIOPA-BoS-14/109, 29.09.2014; The EBA Multi-annual work programme 2016-2018, 30.09.2015. Information from staff of each of the ESAs on monitoring indicators, obtained during the spring of 2017

<sup>144</sup> On occasion the ESAs' staff indicates that resource constraints have influenced the number of trainings and workshops carried out.

indicators submitted by ESA staff confirm this. Specific examples demonstrating the use of the practical convergence tools include: ESMA published its first annual work programme on supervisory convergence in February 2016 and has recently adopted a second annual work programme on supervisory convergence. ESMA has established a Supervisory Convergence Standing Committee ("SCSC") and has committed, in its Strategic Orientation 2016-2020, to deploy a wider range of supervisory tools. To ensure common understanding of effective supervision EIOPA regularly engages bilaterally with national supervisory authorities. It provides balance sheet reviews and technical assistance. EIOPA further promotes the creation of cooperation platforms in situations where a college of supervisors is not formed but where cross-border risks are identified. It has created a Colleges Action Plan. Upon request, EIOPA assesses the risks posed by specific undertakings, including cross-border issues and recommends remedial actions. EIOPA has pointed out though that in the area of insurance and internal models efforts to ensure consistency through participation in the colleges and targeted exercises has not been sufficient and inconsistencies between internal models have been observed across the EU. EIOPA explains that this is partly because EIOPA lacks sufficient powers to ensure consistency in the approval of group internal models.<sup>145</sup> The EBA has contributed to significant progress in supervisory engagement, assessment and articulation of additional capital requirements through the implementation of the EBA guidelines on the supervisory review and evaluation process ("SREP").

This evaluation is broadly supported by a majority of stakeholders responding to the ESA public consultation, who also indicate that in recent years progress has been achieved in promoting a common EU supervisory culture and increasing convergent supervisory practices. Some point to this as an achievement especially given scarce resources and since the ESAs became operational only in 2011.

On the other hand, the ESAs have not used all their available powers to ensure regulatory and supervisory convergence. The ESAs were also granted powers to settle disputes between NCAs and to pursue breaches of EU law. They were also granted powers to carry out peer reviews and to follow up with recommendations and guidelines to NCAs. As regards the use of these powers, there seems to have been little (if any) noticeable use by the ESAs in relation to mediation and breach of EU law investigations, in particular, but also in relation to peer reviews. This is to some extent corroborated by information provided by ESA staff. For example, ESA staff has submitted information on the number of peer reviews conducted, the number of mediation cases (including requests for mediation) they have been involved in and the number of warnings issued in relation to an alleged breach of EU law. On that basis it emerges that:

- EBA and ESMA have carried about one peer review per year on average. EIOPA has carried out between 2 and 6 peer reviews per year between 2014 and 2016.

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<sup>145</sup> Some respondents to the public consultation acknowledge that the approval of internal models raises issues, e.g., inconsistencies in terms of what national CAs require and approve, the evidence they accept, their approach to expert judgment and the time they take to decide on the application.

- EBA has received a total of nine requests for mediation (three binding and 6 non-binding) in the last three years. One was withdrawn, one is on-going and the remaining seven resulted in a settlement agreement. Since its inception, ESMA has never received a request for non-binding mediation. It has received one request for binding mediation, which resulted in a settlement agreement. EIOPA has never been involved in a case involving binding mediation but has been involved in three conciliation cases per year on average since 2014.
- EBA has issued one warning in 2014 for a manifest breach of EU law. It has on three occasions informally raised concerns with NCAs that has resulted in the CAs changing their behaviour. ESMA has issued one single recommendation to adopt a warning on a manifest breach of EU law, which however was not adopted by the Board of Supervisors. Finally, EIOPA has never issued a warning on a manifest breach of EU law.

Establishing quantitative benchmarks or targets on ESA activity in these areas would require establishing an accepted counterfactual scenario. This is inherently complex, given the discretionary nature of these powers. It would require identifying all cases where an ESA should have come to a specific decision and contrasting it with the decisions actually taken. Establishing such a counterfactual would require having the same information set and resources as the ESAs over the entire evaluation period and is hence beyond the scope of this evaluation. That said, the low number of non-regulatory decisions (mediation, breach of EU law procedures), including peer reviews, over a period of six years, is taken as a first indication of insufficient action in these areas. This is corroborated by qualitative information and informal information about existing, yet unsettled, cross-border disputes.

Several factors are likely to influence the use of these tools and the lack of progress in this area. From the Commission's own experience participating in Board meetings and discussing with ESA staff, from the previous evaluation made in 2014 and from reviewing the monitoring indicators it seems that the relevant, existing powers granted by the ESA Regulations are not always sufficiently clear and/or too narrow or simply constructed in a way that does not incentivize their use. This makes it more difficult for the ESAs to make effective use of them. This is especially so with respect to peer reviews, the follow-up of peer reviews, dispute settlement and breach of Union law investigations.

For example, peer reviews could be subject to independent assessments. The ESAs could solicit comments from stakeholders during peer reviews and the results of the peer reviews should be published. In relation to dispute settlement, the powers could be strengthened by extending the number of cases where the ESAs can initiate dispute settlements. The current text of the ESA regulations limits the ESAs involvement to situations where sectoral legislation provides for it. Sectoral legislation essentially only foresees that the process is initiated by competent authorities. ESA staff has also highlighted diverging interpretations of the provision in relation to whether the ESAs can intervene to settle disputes by way of a binding decision in situations involving supervisory judgment. In relation to dispute settlements, EBA specifically explained that in cases where parties would not settle disagreements during the conciliation phase it could be challenging for EBA to settle

disagreements with a binding outcome. This is because the current provisions in the EBA Regulation are not sufficiently clear on when EBA can take a decision that resolves the dispute, as the set-up of the mediation panels is not always conducive to mediation especially within tight deadlines. EBA also pointed out that it does not have a mandate under the BRRD to trigger binding or non-binding mediation on its own. ESMA pointed out that it has no right of initiative at all to trigger binding mediation. This suggests that there is merit in clarifying the use of the dispute settlement process to incentivise a more effective use of these powers. The ability of the ESAs to start an investigation and the quality of the investigation depends on information available to the ESAs. Right now the information only comes from the party being investigated which does not seem to contribute to an effective use of that provision. In this context it should also be noted that the ESAs currently lack the ability to enforce their requests for information in a simple and swift manner.

In sum, the evaluation of the effectiveness and efficiency in the use of ESA powers in respect of regulatory and supervisory convergence are mixed. Convergence in certain areas is still insufficient to ensure consistent application of EU law, either because available tools have not been used to their full extent (e.g., dispute settlements, breach of Union law proceedings and peer reviews) or because ESAs' mandate was insufficient to overcome national fragmentation. These shortcomings in the effectiveness of the ESAs are already a source of concern, but will become increasingly problematic in the context of renewed efforts to integrate the EU financial markets in the post-crisis era. In particular, the role of the ESMA in both promoting and facilitating the creation of a CMU via greater supervisory convergence will be crucial and it would seem that enhanced powers will be required.

This evaluation of the ESAs' use of powers in respect of regulatory and supervisory converged is mirrored in responses to stakeholder consultations. Stakeholders have noted that, in relation to supervisory convergence work, this apparent under use of powers has partly to do with the fact that significant resources within the ESAs have been allocated to the preparation of technical standards to the Commission and that this has impacted on the amount of resources the ESAs can devote to other policy areas including supervisory convergence work. In relation to breach of Union law procedures, stakeholders often mention that they should be simplified and faster, that the ESAs should motivate and make public any decision not to launch an investigation, or that the ESAs should be allowed to conduct on-site inspections at NCAs in the context of investigations. Stakeholders also suggest that lack of effective use of powers is related the current governance set-up of the ESAs which may deter the use of powers in certain situations or taking decisions in the interest of the EU as a whole (e.g., in relation to follow-up recommendations from peer reviews, binding mediation or the initiation of breach of Union law procedures). This is because ESA decisions are taken by the very same parties (i.e., NCAs) to which the decisions apply and this inherent conflict of interest objectively puts all parties in a difficult position (for more on the governance structure and any impact on the use of powers, *see* the following section on governance).

#### Cross-border situations

On a broader level, the ESAs work should also deliver more effective oversight of the financial institutions and markets and provide EU solutions to cross-border issues both within the EU and beyond. Compared to the baseline, it is evident that in terms of powers and engagement in supervisory colleges, the ESAs are much better equipped than the Committees of Supervisors to contribute to the strengthening of the Single Market in financial services, to ensure EU level regulatory and supervisory convergence and to minimize regulatory arbitrage.

However, the ESAs are increasingly operating in an environment which is substantially different to when they were established. There has been a significant growth in cross-border financial services<sup>146</sup> and an increase in EU financial service legislation the last years.<sup>147</sup> This has significantly added to the responsibilities of the ESAs since legislative acts increasingly foresee a role for the ESAs. There has also been the development of the Banking Union and now the need to develop a well-functioning CMU. As a consequence of increased integration of financial markets and services this has created increasing imbalances of supervisory competences between the national and EU level. With the exception of the SSM in the banking sector there is no other EU level supervisory authority to deal with increased pressure to ensure EU level harmonization of regulatory requirements as well as of supervisory responsibilities. This may raise effectiveness issues going forward, especially in relation to the development of a CMU. Considering therefore the acceleration towards more integrated capital markets and the increased pressure that the United Kingdom's decision to leave the EU will put on capital markets supervisors it seems that especially ESMA's current powers may not be sufficient to ensure an effective level of supervision going forward.

For example, certain funds such as EuVECA,<sup>148</sup> EuSEF<sup>149</sup> and ELTIF,<sup>150</sup> are highly concentrated in few countries. In the current EuVECA/EuSEF frameworks, there are only limited powers attributed to ESMA. For example, ESMA maintains a central database, publicly accessible on the internet, listing all EuVECA/EuSEF managers and the funds that they market, as well as the countries in which those funds are marketed. Moreover, in the event of disagreement between NCAs on an assessment, action or omission where it is required cooperation or coordination between NCAs, they may refer to ESMA, which may act in accordance with the ESMA Regulation. While the experience with the databases has seen a slow start, due to some initial technical difficulties, compared to the past, ESMA is now providing for a central point gathering information on such funds and is fostering effective regulatory cooperation among the entities tasked with supervising compliance of such funds.

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<sup>146</sup> See the European Commission (2017), Staff Working Document, Economic Analysis accompanying the Communication on Capital Markets Union Mid-Term Review, Chapter 1, page 11; and European Commission (2017), European Financial Integration and Stability Review, May, page 18.

<sup>147</sup> See Annex 11.4 for a comparison of legislative texts when the ESAs were created and now.

<sup>148</sup> Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds.

<sup>149</sup> Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds

<sup>150</sup> Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds

With the recent EuVECA and EuSEF review, ESMA's role will now be enhanced through the collection of data on funds registration for the purposes of peer reviews performed by ESMA.

However, it is clear that the functioning of effective supervision in relation to these funds is increasingly impaired by national approaches to registration and supervision due to their small size (on average). Current ESMA powers therefore seem too limited to ensure regulatory and supervisory convergence for these standardised funds, which are operating in a highly concentrated and integrated market. The initial administrative requirements at the point of registration or on-going supervision remain to vary considerably across Member States, being thus prohibitive *per se* and creating an unlevelled playing field. While the majority of the limited number of stakeholders relying on direct supervision of the asset management industry see NCAs' better placed to perform this function, a significant part – mainly the industry which is active across borders – recognises potential merits in ESMA's direct supervision of EU regulated investment funds or those conducting cross-border activities.

Another example where ESMA has limited tools set out in legislation, but where it has gained extensive expertise over the years, is in relation to prospectus approvals. Since 2011, ESMA has invested significant time and effort to foster regulatory convergence amongst national CAs with regard to the scrutiny and approval of prospectuses. This has led to the creation of a "Supervisory Briefing", including commonly-agreed principles which national CAs. ESMA has also carried out two peer reviews on the prospectus approval process, as evidence emerged of diverging practices among Member States.<sup>151</sup> Nonetheless, those actions have been unable to promote supervisory convergence and the landscape of prospectus approval requirements remains fairly fragmented across the EU.

A final example concerns ESMA's role in managing data created as a result of EU legislation, like data reporting in MiFID and with the direct supervision of trade repositories collecting OTC derivatives data. Financial markets rely on sound and reliable information. The fragmentation of supervision on data has led over the years to the proliferation of different standards and commercial practices, which have also contributed to divergent implementation of EU law or non-application (as in the case of the consolidated tape provider under MiFID). ESMA has tried to achieve more consistency and coherence by centralising data through the use of voluntary delegations of powers. Delegations however are difficult to put in place and remain vulnerable. In view of the necessary increasing role that ESMA will have to play as a financial market data supervisor and in anticipation of new legislation coming into force, the current system where registration and supervision of data reporting service providers (whose business is predominantly of a cross-border nature) by national CAs risks being not fully effective. In effect, national CAs might not have the necessary capacity to detect, assess and monitor potential problems emerging from the cross-border nature of the activities that such data service providers offer. Few stakeholders, mostly from industry, responded specifically to the question on data providers. Of those, a majority, including ESMA, fully supported the idea of ESMA directly supervising data providers – while many other respondents gave qualified support to the idea.

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<sup>151</sup> See ESMA/2012/300 and ESMA/2016/1055.

In addition to the examples above, there are a few areas where the existing powers in relation to international relationships could have been better defined and therefore have not been as effective as they could have been, even though the ESAs clearly have had more impact in this area compared to the baseline scenario where there was no such role foreseen for the Committees of Supervisors. In view of increased interconnectedness between the EU and the rest of the world and the increased need to monitor and manage cross-border risks effectively, this puts into question the effectiveness of the current framework also going forward.

For example, the ESAs' role in the equivalence processes is not always made explicit in financial legislation, which has created substantial uncertainty in terms of planning and resource allocation (for both the ESAs and the Commission). Sometimes the ESAs' opinions or initial assessments are mandatory; in other cases, the legislation is simply silent on how they should be involved because the type of equivalence sought is more appropriately addressed by the Commission. Sometimes, ESAs may be providing technical assistance in response to ad-hoc requests from the Commission without a specific mandate in the legislation. It has also happened that the ESAs declined<sup>152</sup> requests from the Commission to support equivalence assessments absent an explicit legal mandate. Had the role of the ESAs been more explicit in sector legislation it would have been easier for the Commission to involve the ESAs and for the ESAs to justify the necessary resources and prioritization of that type of work.

### Consumer oversight

The ESAs' work is also supposed to result in greater oversight of risk to consumers and investors. While the relevant scope for action laid down in the ESA Regulations is broad, the ESAs' work programs suggest a relatively conservative use of resources in this area. A more proactive approach would seem necessary based on a clarification and enhancement in the ESAs' powers in the consumer protection area, including in sectoral legislation. The ESAs themselves have acknowledged that the consumer protection work needs to be strengthened and that the Joint Committee of the ESAs should be more effective in ensuring proper consumer and investor protection in its joint work.

This evaluation is only partly supported in stakeholder consultations, with mixed views on the ESAs' work and available tools and powers in relation to consumer protection. One set of stakeholders believes that current tools and powers are adequate and that the ESAs are doing a good job even though more could be done. Others take the view that there is room for extending/enhancing the powers of ESAs, referring to, for example, the need to clarify the ESA's consumer protection objective and scope of this work, and to clearly give the ESA's the right to prohibit or restrict certain products for investor protection purposes, and include consumer credit in the scope of EBA. There are also stakeholders that note that the ESAs

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<sup>152</sup> Article 34 of each ESA regulation provides that ESAs may provide an opinion on all issues related to their respective area of competence either on their own initiative or upon a request from the European Parliament, the Council or the Commission. Explicit rules on the contribution by the ESAs to the Commission's activity regarding equivalence decisions, including ex post monitoring, would help clarify the ESAs' obligations in the matter.



Joint Committee could take on a greater role and that cross-sectoral issues should be dealt with there. There are also stakeholders that argue that consumer protection should be mainly the responsibility of national competent authorities and ESAs should focus only on co-ordination.

#### Coordination micro- and macro-prudential policies

The ESRB and the ESAs are required to cooperate with each other and share information of importance to systemic risk across sectors. To date, the EBA has had the most active relationship with the ESRB, reflecting the role of both bodies in managing the banking crisis. As members of the ESRB General Board and Steering Committee, the ESA Chairpersons are actively involved in ESRB meetings and decision making. The Chair of the Joint Committee of the ESAs is also Vice-Chair of the ESRB. In addition, ESA staff participates in various ESRB Committees and working groups at times taking a leading role of specialist subjects. The ESRB Secretariat also participates in the ESA Board of Supervisors meetings and in Standing Committees and Sub-Groups as well as the Joint Committee.

In the context of the ongoing review of the ESRB, the Commission is reflecting, among others, on enhanced ESRB governance. As the Steering Committee of the ESRB notably comprises the 3 chairpersons of the ESAs, this would contribute to the reinforcement and better coordination of the overall ESFS. An effective cooperation between the ESRB and the ESAs has also been mentioned as a necessity at the public hearing on the macro-prudential framework. In this respect, the Commission will continue to closely look at the overall coherence of the ESFS.

This enhanced cooperation would also mirror, to some extent, the global cooperation mechanisms in the field of financial stability, with the Financial Stability Board bringing together not only national and regional authorities of G20 countries and other key financial centres, but also global standard-setters, amongst others in the field of banking, insurance and financial market infrastructures. The Financial Stability Board mainly acts as a coordinating body, operating by moral suasion and peer pressure, to set policies and minimum standards that its members commit to implement at national level. The ESRB has a key role in ensuring a consistent approach across the EU and examining cross-border effects of the use of macro-prudential instruments at the country level. Both share the will and mandate to have a holistic, "systemic" and macro-financial view on financial stability risks, with important input from sectoral authorities or standard setters.

Supervision of some entities and activities within the EU financial system, e.g. EU label funds and data reporting services providers, have a clear EU dimension. Spreading responsibility for supervision in these fields across many national authorities may be inefficient and so result in sub-optimal outcomes in terms of financial stability, market integrity, administrative burden etc. From this perspective, granting supervisory power to an EU body in these fields would be more efficient as it would concentrate the costs of supervision in only one authority avoiding any overlaps. In particular, granting of new direct supervisory powers would be both beneficial with regard to the coherence of the assessment of the relevant activity across EU

and raise efficiency of the supervisory process by smoothening decision-making process and reducing administrative burden for the supervised entities.

The use of supervisory resources allocated to supervision of entities under new direct supervisory powers should be optimised. In addition, the ease of interaction with entities subject to ESMA's direct supervision (one-stop shop) would be enhanced. Moreover, one would expect a further reduction in overall cost of supervision since centralising the supervisory activities in ESMA creates economies of scale which imply an overall reduction of costs in an aggregated level within the EU. Furthermore, the more efficient supervisory structure also means that decisions in individual cases would be taken in a timely manner; the risks of incoherent application or conflicting competences would be eliminated. Finally, regarding administrative burden reduction, the decrease in overall cost for the new direct supervisory powers would also be due to the fact that there will be less coordination costs in the sense that ESMA will not any longer have to transmit back and forward several documents to the competent authorities which in turn creates an excessive administrative burden and lengthens the whole supervisory process. Overall, in terms of efficiency one should expect clear efficiency gains based on the fact that heavy coordination procedures will be avoided and resources and expertise will be pooled in one organisation.

### **Evaluating the effectiveness and efficiency of ESAs' governance**

Compared to the previous Committees of Supervisors (baseline), the ESAs' governance structure features a number of notable enhancements. In the Committees of Supervisors, for example, decisions were taken by Member States representatives without the presence of independent members. This is no longer the case as both the Commission and other EU bodies are present at Board of Supervisor meetings, and the Commission is also participating in Management Board meetings where it can vote on issues relating to the budget of the ESAs. Although only the representatives of the NCAs have a right to vote, decision-making has been facilitated by the general use of simple-majority voting with qualified-majority voting on specific topics. Consensus or qualified majority voting was the rule in the case of the Committees of Supervisors.

Despite the improved governance arrangements within the ESAs, there remains scope for further action. This view is based on informal evidence provided by EBA staff, the outcome of previous evaluations made by the Parliament and the Commission, as well as Commission staff experience working with the ESAs and participating in their Board meetings. The main area of concern with the current governance arrangements relates to the composition of the Board of Supervisors and the Management Board which remains dominated by national authorities and so does not foster effective and efficient decision making on matters where there is a strong EU interest. The potential for incentive misalignment - between EU and national interest – clearly exists and must be managed appropriately if the ESAs are to deliver on their mandates in full.

From a purely conceptual point of view, the current government set-up has considerable flaws, as it allows for conflicts of interests that are likely to produce an inaction bias, and prevent the ESAs from acting in the interest of the EU as a whole. This is essentially because decision-

makers have two mandates – a national and European one - and may find themselves in a position where they may have to arbitrate between national and European interests. The quantitative and qualitative evidence provided in relation to use of powers illustrates this inherent challenge. In particular, non-regulatory decisions (breach of EU law decision, peer reviews, binding mediations) have been used very sparsely. While the limited activity in the supervisory area may in parts be due to a number of compounding factors (also highlighted in this evaluation, such as an unclear definition of powers), there are indications that confirm that an unwillingness to take actions vis-à-vis individual national CAs has been present since the set-up of the ESA. While it is impossible to provide an uncontroversial counterfactual estimate of the number of actions and decisions that should have been taken under an "optimal" governance structure, this apparent inaction bias strongly suggests that the number of non-regulatory decisions has fallen short of what would have been observed under a better incentive-structure.

While the Management Board – which comprises the Chair, the Executive Director and representatives of selected NCAs – could help to ensure more effective decision-making within the ESAs no formal role in this regard is foreseen in the ESA Regulations. In fact, the formal role foreseen for the Management Board and its tasks are very limited. Moreover, the formal role and powers provided to the chairpersons in the ESA Regulations is also very limited and the fact that they are appointed by the Boards of Supervisors may reduce their authority and independence. The unclear allocation of tasks between the Board of Supervisors and the Management Board and the lack of formal powers attributed to the latter, has impeded swift decision-making. This notably concerns the Management Board's lack of formal powers to examine, prepare and propose decisions notably in the non-regulatory areas, to the extent that such decisions would not be impeded by conflicts of interest in the first place. Similar views were brought forward in the ESA public consultation.

The impact of the ESA's current governance arrangement on the use of powers impacts predominantly on supervisory convergence. Information on the use of peer reviews, dispute settlements and breach of Union law investigations provided in the section on powers above indicates that the ESAs may be underusing their powers in this area. It is precisely in these areas that conflicts of EU and national interests tend to arise, leading to inaction bias under current governance arrangements.<sup>153</sup> The "repeated game" nature of decision-making in these areas may also deter NCAs from supporting ESA action against peers, if there is a risk that they may find themselves in a similar situation in the future.

The concerns about ESA governance arrangements are not new and there have been calls for changes to the governance structure in the past. The Parliament for instance recommended in its 2013 review of the ESAs<sup>154</sup> that operational improvements in the governance structure

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<sup>153</sup> This conflict is apparent also in relation to the SSM as it is not uncomplicated for the EBA to ensure that the SSM is compliant with the Single Rulebook, and to ensure SSM alignment of supervisory practices and supervisory outputs, including compliance with EU law, as procedures against the SSM require a majority of the national CAs in the EBA Board of Supervisors to take a stance different from the one adopted by the same national CAs in the SSM Supervisory Board.

<sup>154</sup> [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507446/IPOL-ECON\\_ET\(2013\)507446\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507446/IPOL-ECON_ET(2013)507446_EN.pdf)

should be introduced (i.e., creating an Executive Board with more operational tasks) and the statutory profile of the Chairpersons should be raised (i.e., granting the Chairperson voting rights or changing the appointment procedure). The IMF<sup>155</sup> also called for changes in the governance arrangements for the ESAs, with the aim of strengthening their operational independence and effective accountability, which would help to overcome the domination of national interests in decisions of the Boards of Supervisors, and facilitate rapid decision-making. This was also recognised in the November 2014 ECOFIN conclusions on the ESFS<sup>156</sup> where it was noted that considerations should be given as to " how to improve the governance of the ESAs to ensure that decisions are taken in the best interest of the EU as a whole while preserving the careful balance reached in the context of the establishment of the SSM, having regard to the expertise provided by the national competent authorities".

Changes in the governance arrangements were not considered on the basis of the previous Commission review of the ESAs in 2013. This was because it was not deemed appropriate to make such a fundamental reform of the Authorities after only three years of operation. Now, however, it would seem necessary to consider a reform of the governance arrangements, based on experience with a longer period of operation and in the perspective of renewed efforts to foster the integration of EU financial markets, The objective would be to use such a governance reform to achieve an improved balance between EU and national interests in the decision-making process. A possible reform in this direction would be to strengthen the EU interest within the governance arrangements, perhaps by strengthening the role of the chairman and/or by having more voting members who are independent of national interests

ESA's governance was also a topic in the stakeholder consultation. About one third of respondents - mainly public authorities, notably central banks and supervisors, as well as some industry associations - provided a broadly favourable opinion of the ESAs' governance. Many of these respondents rejected the suggestion of inherent conflicts of interest within the ESAs. However, even among those that consider the governance to have worked broadly well recognize the potential utility of having a separate group looking at supervisory convergence issues. On occasion it is mentioned that this should also incentivize the ESAs to make more use of certain powers.

Other respondent offered a more critical assessment of governance arrangements, focusing on composition of the Boards and the structure of the decision-making bodies, voting powers, etc. and with suggestions on how to mitigate shortcomings varying both in terms of content and level of precision. For example, some stakeholders call for an independent oversight body to look over the operations of the ESAs. Several others rather comment on the fact that the composition of the ESAs' Boards is dominated by NCAs. Others voiced concerns that processes and decisions are approached with the national perspectives rather from an EU-wide perspective. Some stakeholders note that changing the composition of the Management Boards by introducing independent members could introduce more neutrality in discussions and decisions. A few respondents refer explicitly to the ECB, SSM and SRB governance as possible governance models.

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<sup>155</sup> IMF Country Report No. 13/65, March 2013.

<sup>156</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/145696.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/145696.pdf)

Views on the need to strengthen the role and mandate of the Chairperson are split. A small number of respondents comment on the dual role of the Chairperson sitting on both the Board of Supervisors and the Management Board, which in the view of those respondents makes it more difficult for the Board of Supervisors to exercise effective oversight over the Management Board. The fact that the Chairperson chairs both Boards places him/her in a position where he/she can exercise a very high degree of influence on the decision-making of the Management Board. This, in combination with the lack of any external or independent members on the Board of Supervisors, implies that power in decision-making is heavily concentrated and not subject to sufficient oversight. Conversely most other respondents emphasize the importance of strengthening the Chairpersons by granting them more formal powers and a voting right to strengthen accountability and the decision-making process in the Board of Supervisors.

A very small number of respondents mention that the capacity and the role of the Joint Committee should be developed taking into consideration that there will be more and more issues with a cross-border and cross-sector dimension in the future. To this end, the decision making procedures of the Joint Committee should be developed to allow a less bureaucratic decision making and still raising openness and publicity of the decisions of the ESAs in general.

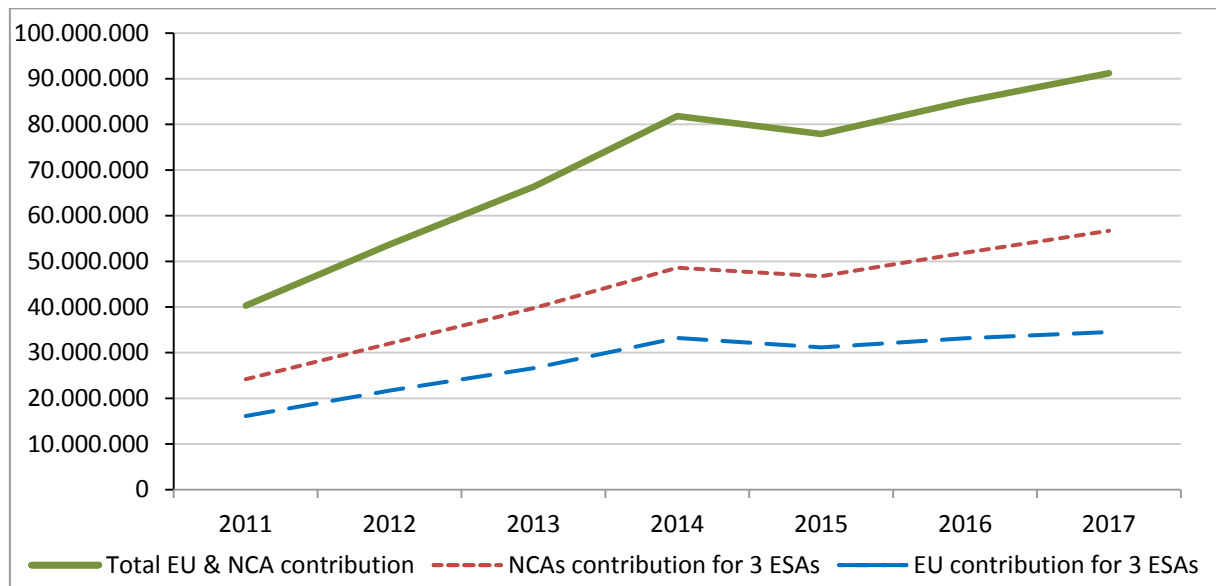
Finally, respondents to the public consultation note that the role of stakeholder groups is valued but that their impact is limited. Reasons mentioned include an unbalanced composition which also leads to coordination problems, lack of information and lack of time for proper consultations.

In sum, the ESA governance has implied an increase in effectiveness relative to the baseline. However, the failure of the ESAs to use certain powers – notably in the area of supervisory convergence – seems attributable to conflicts between EU and national interests within the decision-making process. These conflicts could be managed in a more balanced way through changes in governance framework that would be designed to ensure more balance between EU and national interests in the composition and voting rights of the ESA Boards of Supervisors

### **Evaluating the effectiveness and efficiency of the ESAs' funding arrangements**

ESAs funding arrangements under the ESFS regulation involve contributions from the EU budget and from NCAs in a ratio of 40:60. These arrangements have been more effective than the arrangements for the predecessor Committees of Supervisors, which were based solely on funding by NCAs. The new arrangements have enabled the ESAs to expand both in budgetary terms and in terms of staff numbers so as to meet the objectives prescribed in their founding Regulations. The following graphs denote the evolution of the combined budgetary means and human resources levels.

**Figure 1: ESAs budget 2011-2017**



Name of the decentralised agency	Location	Year of creation	Total number of posts (authorised by EU budget)					
			2012	2013	2014	2015	2016	2017
European Banking Authority (EBA)	London	2010	68	93	103	111	125	134
European Insurance and Occupational Pensions Authority (EIOPA)	Frankfurt	2010	69	80	84	87	92	101
European Securities and Markets Authority (ESMA)	Paris	2010	75	121	128	133	138	150

Source: European Commission

The ESAs total budget has more than doubled during the first years of their operations, with an average growth rate of more than 25% per year (Figure 1). This budgetary expansion during the start-up phase reflects ESAs increasing workload in order to fulfil their mandate with particular emphasis to build single regulatory and supervisory frameworks (single rulebooks) for their respective areas of competence. Thereafter, the EU MFF 2014-2020 set ESAs budget growth to approximately 8% per year until 2018. From 2019 on, ESAs were assumed to reach cruising speed implying a lower growth rate in budgetary resources. This

limitation to ESAs budgetary expansion is due to the fact that the 2014-2020 MFF introduced general budget cuts relative to the 2007-2013 period.

A limitation on the ESAs financial resources, in particular in times of sudden changes to budget needs, comes from the fact that the ESAs are not allowed to keep budget surpluses. The mentioned limitation results from the FFR. According to current financial rules, the ESAs return any financial surpluses to the EU on an annual basis. Subsequently, i.e., in the following year, ESAs are entitled to claim back 60% of the past surplus amount, which is then redistributed across NCAs. Usually, the amount is deduced from their contribution obligations. The absence of the ability by ESAs to retain budget surpluses may reduce the smoothness of the ESAs budgets in certain situations. For example, in case an unexpected financial need would arise in an ESA linked to increased financial market risks or a financial crisis, tapping on budget surpluses could be an easy solution to cover temporary budget gaps. Member States, companies, financial and other organisations often use reserves to level out their budget fluctuations.

The existing fixed distribution of funding between the EU and the national CAs puts further constraints on the ESAs budget and reduces the ESAs' capability of dealing with unforeseen and unforeseeable circumstances. Illustrating the mentioned challenge, a number of NCAs have raised the issue of increasing difficulties in contributing to the ESAs' budgets due to budgetary constraints. The MFF has capped the EU annual contribution to the ESAs budget to a maximum annual lump sum, which in 2020 reaches approximately EUR 16 million for EBA, EUR 9.9 million for EIOPA and EUR 12.3 million for ESMA. The listed figures mean that the ESAs cannot grow by more than planned under current financial arrangements.

Discussions with ESA staff and testimonies provided before Parliament confirm that due to insufficient funding levels the ESAs have experienced difficulty in meeting their objectives in a number of areas such as assessments of third country equivalence and consumer protection, and have not progressed sufficiently on supervisory convergence. For example, the Commission's decision on delegated acts were occasionally delayed, leading to delays in the implementation of Level 1 and Level 2 legislation,<sup>157</sup> and some initiatives and tasks got deprioritised.<sup>158</sup> In addition, one of the ESAs had to reduce and temporarily suspend its financial market monitoring activities. In addition, due to limited resources, the ESAs could not make full use of the abundant financial market data they have at their disposal. Information provided by the ESAs on monitoring indicators also illustrates that because of budgetary constraints supervisory activities such as, for example, training has had to be reprioritized.<sup>159</sup>

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<sup>157</sup> For example, EBA's advice on equivalence of third country regimes and the technical standards on anti-money laundering

<sup>158</sup> For example in order to address budget constraints, ESMA deprioritised (removed) from its IT Work Programme 2017-2019 the development of the European Electronic Access Point (EEAP) in favour of the implementation of the Prospectus Directive and Money Market Funds Regulation projects.

<sup>159</sup> Staff of each of the ESAs provided monitoring indicators to the Commission during the spring 2017 for the purposes of the evaluation.

Linked to the mentioned problems, several reports from the Parliament, from the Council and from the ECA<sup>160</sup> noted that the ESAs funding levels are insufficient. In particular, the Committee on Economic and Monetary Affairs in their annual Opinions prepared for the Committee on Budgetary Control on the ESAs budget execution has repeatedly stressed that the ESAs current financing arrangement was inadequate, inflexible and burdensome.<sup>161</sup> In its 2014/05 report, the ECA stated that "*overall, EBA's resources during its start-up phase were insufficient to allow it to fulfil its mandate*".<sup>162</sup> In particular, the ECA also found that the EBA lacked resources to fulfil its consumer protection mandate and to conduct the 2011 stress tests.

On the other hand, the ESAs have used their available resources efficiently. The current funding framework requires the ESA financial rules to be tightly aligned with the provisions of the Commission's FFR. Any divergence from the FFR requires prior approval by the Commission. The ESAs have established internal control procedures to oversee the budget execution through quarterly reports to their Management Boards on the progress of the execution of the budget. Since 2013, the ESAs have been using a system of performance indicators to monitor progress vis-a-vis their budget execution. Their accounts and the use of resources are audited on an annual basis by the ECA. In addition, every financial year, the Parliament, following a recommendation from the Council, grants discharge to each ESA for the implementation of their budget. This process ensures maximum scrutiny and accountability of ESAs budget execution and has resulted to keeping the cost down and increase operational efficiency. Due to such operational efficiency, the ESAs could still meet its objectives to a large extent, even though since 2015 they were receiving approximately 10% less of what they actually had estimated for operating effectively (annual budget requests). However, it would seem that the limits of efficiency in allocating budgetary resources have been reached and will not help the ESAs to meet their objectives in the context of expanding responsibilities within a more integrated EU financial system in the coming years.<sup>163</sup>

## **Figure 2 - Difference between ESAs budget request and adopted budget (2012-2017)**

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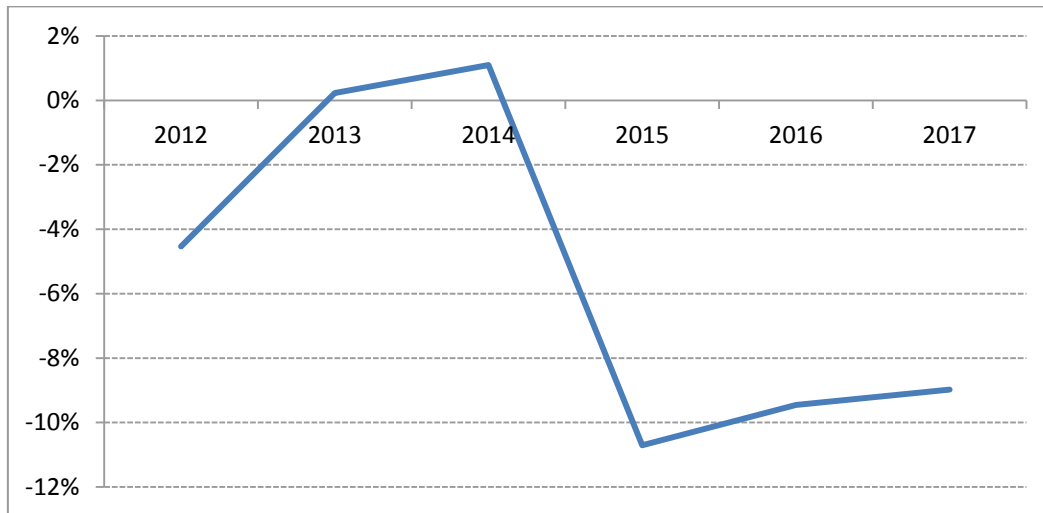
<sup>160</sup> See stakeholder replies to the Commission's 2014 Review Report, the Parliament's 2013 Review Report of the ESFS, the IMF Country Report No 13/65 on the Financial Sector Assessment of the European Union – Issues in Transparency and Accountability; the Parliament's 2014 Resolution on the European System of Financial Supervision Review; the 2014 Council conclusions on the ESFS Review, the 2016 Parliament Resolution on the Stocktaking and challenges of the EU Financial Services Regulation, testimonies before national parliaments, and the ESAs during Parliamentary hearings.

<sup>161</sup> ECON 2014/2122(DEC) published 26.2.2015; 2014/2121(DEC) published 26.2.2015; ECON 2016/2186(DEC) published 1.3.2017;

<sup>162</sup> 014/05, Special Report European banking supervision taking shape — EBA and its changing context, p.8 point IV.

<sup>163</sup> The problem of the sustainability of the ESAs budget is further elaborated in section 8.2 of the Impact Assessment





2012	2013	2014	2015	2016	2017
<b>ESA budget request €</b>					
59,373,000	72,755,000	87,426,800	98,148,500	105,572,036	113,173,000
<b>ESAs adopted budget €</b>					
56,681,200	72,923,579	88,386,458	87,642,555	95,590,174	103,013,253

Source: European Commission

In the stakeholder consultations on the ESAs, only a few respondents (from the full range of categories) referred to the current funding framework and whether funding levels have been commensurate to what is necessary for the ESAs to fulfil their objectives and tasks. However, those respondents pointed to the fact that the ESAs struggle to find ways of making their available funding meet their requirements. A few stakeholder groups or representatives of consumers also pointed to the fact that a limited budget has several drawbacks both in terms of securing adequate staff and managing consultation with all stakeholders.

From the Commission's point of view it is understandable that among the general public very few address the issue of sufficiency as it is difficult for external stakeholders to have that type of detailed insight into the administration of the ESAs. This should be contrasted by the views of the EU Budgetary Authority which at each discharge of the ESAs' budget has concluded that the ESAs' budget levels have been insufficient and should be changed<sup>164</sup>.

Views expressed in the 2017 public consultation confirm that the ESAs are under resource constraints, negatively affecting their ability to carry out their tasks.

Regarding possible solutions, stakeholder views diverge significantly with respect to where the contributions to the ESAs activities should come from. With the exception of just a few, virtually all industry respondents do not support moving to a system where the ESAs are funded fully or partially by the industry. Also a small number of national institutions/authorities do not support industry contributions. Broadly the reasons provided for not charging the industry include that: charging fees is only justified where entities are

<sup>164</sup> For more information see discussion in section 8.2

directly supervised; that there should be no duplication of payments for the industry; that the ESAs work is a public good for which the public should be pay; and that supervisory convergence work should be funded by national CAs because they benefit directly from convergence work. Most of all there are strong concerns that industry funding would influence the independence of the ESAs and that there would not be a sufficient level of EU control and accountability towards the EU involved in the budgetary process. Contributions from the EU Budget and the application of the EU FFR would secure that.

Consumer organizations and stakeholder groups see merit in industry contributing – both to ensure sufficiency but also to ensure more independence vis-a-vis national CAs and the EU institutions. This group of stakeholders, accompanied by a few national institutions/authorities, are either open to industry contributions (partly not fully) or neutral. However, respondents emphasize that a shift should be accompanied by a thorough assessment on: how to strike the right balance between entities that are subject to direct supervision; pan-European entities not subject to direct supervision; and entities that are active mostly at national level; the impact UK's decision to leave the EU will have on the ESA's supervisory workload; and the population of firms that would be required to provide funding. Any additional industry funding for the ESAs must also be provided to the ESAs on the basis that the ESAs are transparent about how the funding is used, and that the ESAs ensure the additional funding is used to improve their operations in measurable ways. Finally a number of national institutions/authorities argue that the ESAs should be fully funded by the EU Budget as they consider that the ESAs have been created to assist the Commission in performing technical and expert tasks in the financial field and constitute "extensions" of the Commission.

Overall for the period 2011-2017 and in comparison with the baseline, the new financial means provided the ESAs with the ability to perform, to a certain extent, the tasks assigned in the ESA Regulations. However, these means were **not sufficient** to enable them addressing their mandate in full. This was acknowledged, by the European Court of Auditors ("ECA"), which in its 2014/15 report stated for EBA that "*overall, [...] resources during its start-up phase were insufficient to allow it to fulfil its mandate*"<sup>165</sup>.

### **Evaluating the effectiveness and efficiency of the supervisory architecture**

The issue of sectoral versus cross-sectoral supervision has been analysed extensively in economic literature. In addition to academic papers looking into the relationship of the supervisory system with central banks<sup>166, 167</sup> and into the issue of centralising supervision at

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<sup>165</sup> 2014/05, Special Report European banking supervision taking shape — EBA and its changing context, p.8 point IV.

<sup>166</sup> A tendency can be observed across EU Member States towards enhancing the role of central banks in supervisory activities following the financial crisis.

<sup>167</sup> See e.g. T. Padoa-Schioppa, 'EU structures for financial regulation, supervision and stability' and for a broader literature review E. Wymeersch, The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors, 2007 European Business Organization Law Review 8: 237-306.

national and European level<sup>168</sup>, there is an abundant literature<sup>169</sup> on a partial or full integration of supervision of the three classical financial sectors – banks, insurance and securities markets – and the separation of prudential supervision from the supervision of market conduct. .

Analysis of the literature is rather mixed on the relative merits of different supervisory architectures and shows that in general, no one financial supervision model proves unambiguously superior in achieving all the objectives of regulation. Empirical evidence, which exists as to the different supervisory models, is inconclusive and is in any case drawn from different regulatory environments around the world, as noted by the G30.<sup>170</sup> The main tasks of the ESAs (i.e. co-ordination, harmonisation of rules etc.) are not related to direct supervision and evidence related to national supervisors, whose main task is day-to-day supervision of individual entities, cannot be directly applied. Even looking at national models, it is clear that the supervisory architecture varies among Member States. Some Member States have a unitary structure, others have a “twin-peaks” model, and others the sector-based model that is reflected in the current configuration of the ESAs. Therefore, whichever model is pursued for the ESAs, they argue that there will not be perfect alignment in supervisory architecture between the EU-level and national levels.

Various approaches for the institutional structure of the European supervisory system were discussed in the Commission Staff Working Document accompanying the Communication from the Commission 'European financial supervision', which for this particular problem refers to an extensive analytical study by G30<sup>171</sup>. The G30 review - while demonstrating a commonality of challenges faced by supervisors around the globe - shows that many different approaches to supervisory architecture have been chosen to address these common challenges, in alignment with a particular economic, political, and cultural context.

All approaches to financial supervision employed across the globe (i.e., institutional<sup>172</sup>, functional<sup>173</sup>, integrated<sup>174</sup>, or twin peaks<sup>175</sup>) are shown to have both strengths and

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<sup>168</sup> This literature flourished in the context of the Commission proposals for reform of the EU framework for financial supervision in 2009, see e.g. M. Andenas, 'Who is Going to Supervise Europe's Financial Markets', X. Vivès, 'Restructuring Financial Regulation in the European Monetary Union', 19 *Journal of Financial Services Research* (2001) pp. 57-82.

<sup>169</sup> See e.g. C. Briault, 'The Rationale for a Single National Financial Regulator', FSA Occasional Paper No. 2 (1999), or M. Taylor and A. Fleming, 'Integrated Financial Supervision: Lessons from the Northern European Experience', World Bank Policy Research Paper (1999) or D. T. Llewellyn (2006), *Institutional Structure of Financial Regulation and Supervision: The Basic Issues*, presented at a World Bank seminar on *Aligning Supervisory Structures with Country Needs* in Washington DC in June, 2006. For a broader literature review E. Wymeersch, *The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors*, 2007 *European Business Organization Law Review* 8: 237-306.

<sup>170</sup> See the G30 report, "The Structure of Financial Supervision – approaches and challenges in a global marketplace" G30, 9/10/2008, which states "In general, no one model has proven unambiguously superior in achieving all the objectives of regulation."

<sup>171</sup> Idem

<sup>172</sup> The Institutional Approach is one in which a firm's legal status (for example, a bank, broker-dealer, or insurance company) determines which regulator is tasked with overseeing its activity from both a safety and soundness and a business conduct perspective.

weaknesses. In particular, the functional approach to supervision, applied at EU level in the current configuration of the ESAs and at national level in a number of EU Member States such as France and Spain, remains quite common and appears to work well, as long as coordination among agencies is maintained.<sup>176</sup>

The integrated approach, applied *inter alia* in Germany, Japan, and the United Kingdom, proves effective and efficient in smaller markets, where oversight of a broad spectrum of financial services can be successfully conducted by one regulator. The model also has advantages in complex markets where it is viewed as flexible and having a unified focus on regulation and supervision beyond jurisdictional lines. However, while potentially eliminating certain redundancies, an integrated model may create the risk of a single point of regulatory failure. Finally, the twin peaks approach, used *inter alia* in Australia and in the Netherlands to mention a few examples, is designed to reconcile the objective of market conduct integrity and consumer protection with the objective of achieving safe and sound regulation and financial system stability.

In times of increasingly integrated markets within the EU and between the EU and the rest of the world, discussions arise on the possibility to merge certain supervisory agencies, or at least centralising some of their activities, in order to achieve greater effectiveness and efficiency of financial supervision. The economic theory<sup>177</sup> provides a rationale for mergers across entities in specific economic contexts. The theory of economies of scale stipulates that cost advantages arise for organisations due to size, output, or scale of operation, with cost per unit of output generally decreasing with increasing scale as fixed costs are spread out over more units of output. Economies of scale apply to organizational and business situations, such as manufacturing. Thanks to economies of scale, the fixed cost to produce units of output may be lowered.

However, the above reasoning holds only for specific circumstances. There are numerous sectors of economic activity that do not exert economies of scale or are even be subject to diseconomies of scale.<sup>178</sup> As to the latter, diseconomies of scale can be defined as cost disadvantages that firms or organisations accrue due to an increase in size, resulting in higher pro-unit, or average, output costs. Typical situations where diseconomies of scale emerge are

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<sup>173</sup> The Functional Approach is one in which supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Each type of business may have its own functional regulator.

<sup>174</sup> The Integrated Approach is one in which a single universal regulator conducts both safety and soundness oversight and conduct-of-business regulation for all the sectors of financial services business.

<sup>175</sup> The Twin Peaks approach, a form of regulation by objective, is one in which there is a separation of regulatory functions between two regulators: one that performs the safety and soundness supervision function and the other that focuses on conduct-of-business regulation.

<sup>176</sup> See the G30 report

<sup>177</sup> See e.g. Hanoch, G. (1975) "The elasticity of scale and the shape of average costs," American Economic Review 65, pp. 492–497 or Panzar, J.C. and R.D. Willig (1977) "Economies of scale in multi-output production, Quarterly Journal of Economics 91, 481-493.

<sup>178</sup> See e.g. Hsiehchen D, Espinoza M, Hsieh A. Multinational teams and diseconomies of scale in collaborative research. Science Advances. 2015;1(8).

large organisations with complex structures, with several layers of management and with a high degree of bureaucracy. In such cases, the risk of effort duplication becomes high, increasing unit operational costs. In addition, high communication costs result in inefficiencies and further increase operational costs. Finally, any merger of the ESAs would reinforce the need for a review of governance arrangements in order to ensure an effective and efficient balance between benefiting from the input of supervisors in different sectors and achieving the benefits of a cross-sectoral approach. A new governance structure to accommodate the different sectors could be very costly.

Currently, the EU regulatory framework is organised by sector as evidenced by the different directives and regulations defining the scope of action of each ESA. With the notable exceptions of the Financial Conglomerates Directive ("FICOD") and PRIIPs, there is little legislation generally applicable to the three sectors (banking, insurance & pensions and securities markets). In addition the technicality and specifications of the three sectors have increased over the past decade and this calls therefore for a specific regulatory and supervisory approach rather than a holistic one leading to the creation of the single authority. Reflecting this organisation of the regulatory framework, sectoral supervision by the ESAs allows for tailored supervisory approaches to particular business models and specificities of each financial sector. In areas as complex and important as financial services, sector specific expertise should not be underestimated and is absolutely core for effective and efficient supervision. The industry benefits from sector-specific expertise present at each ESA, which is available also for regulatory purposes when developing technical regulatory advice or technical standards. Such sector-specific expertise minimises the risk of inappropriate application of "one-size-fits all" solutions to regulation and supervision of many very different financial entities and activities.

The potential offsetting effects of economies and diseconomies of scale in merging supervisory entities, coupled with the generally accepted finding that no single financial supervision model is unambiguously superior in achieving all the objectives of regulation, weaken the case for introducing significant changes to the architecture of the European financial supervisory system. Moreover, the merger of two or all three ESAs could create a number of uncertainties (legal framework, hesitation in the recruited staff and so on) and possible inefficiencies in terms of restructuring costs. In addition, the location of the ESAs in different EU capitals has not been an obstacle to their successful establishment nor to close cooperation between ESAs.

One area in which **efficiency gains** could be made via a merger of the ESAs might be administrative costs, although the scope for major savings would be limited:

Centralising economic analysis would be possible, but it should be noted that each of the ESAs conducts research in different market segments. In consequence, centralising economic research might bring few material savings. Moreover, there is a risk of losing the current diversity in viewpoints and assessments as instead of ESAs conducting research independently, research by all ESAs would be managed and coordinated centrally. In addition, centralising economic research may come at the expense of in-depth analysis in specialised areas that are within the remit or the interest of only one ESA.

Similar challenges apply to a potential merger of statistical and data management activities. Each of the ESAs has a different degree of data dependency and accesses and uses different sets of data. Moreover, the current system where data is managed separately by each of the ESAs offers a possibility for comparisons and cross-checks on certain financial aggregates and statistics. Such controls would not be possible if data processing is run centrally.

For human resources, procurement and other administrative activities, while a number of processes and activities could be centralised, an important challenge and argument against centralisation is the geographical dispersion of the ESAs. Despite the technological progress in terms of communication and digitalisation, there remain notable benefits for human resources and other administrative units to be located in close proximity to ESAs. Finally, a significant number of human resources, procurement and other administrative activities are ESA-specific which makes them not suitable for centralisation.

For fee collection in a future partly industry-financed framework, the population of entities supervised and subject to fees will be different for each of the ESAs and could well rely on existing, well-functioning national systems already in place.<sup>179</sup> Notwithstanding, the fee calculation process is specific to the type of company, the ESAs could even find synergies to develop a common fee calculation and collection mechanism. In view of the described sectoral specificities, potential benefits resulting from a possible merger of accounting or fee collection departments therefore seem limited.

Overall, it seems that in the European supervisory context the potential benefits from merging a number of more administrative activities and processes across ESAs would be limited, with uncertain efficiency gains.

In sum, the current sectoral model of supervision seems to ensure the greatest possible effectiveness of supervision at EU level while the analysis above indicates that there is no decisive evidence that singles out a model of supervisory architecture as the most effective one with regards to the tasks carried out by ESAs. In this context, it should be mentioned that the vast majority of respondents to the public consultation express a clear support for the current, sectoral model of supervision as having been effective and are against any merging of the ESAs. Several respondents emphasize that now is not the time to consider fundamental changes in the EU supervisory architecture, as the current model has been in place for only six years, significant regulatory changes in all areas are still being implemented (which means that expertise is still building up) and the EU is facing extraordinary challenges with the United Kingdom leaving the EU. Given the ESAs crucial role in ensuring financial stability, it is essential that stakeholders are fully familiar with how the regime operates. Accordingly, the majority view is that there is a need for stability in the supervisory architecture and changing the current architecture is not a good idea at this juncture. A minority of respondents was of the view that the existing overall structure has become cumbersome on the banking side with "confusion" created by interaction of the EBA and the Single Supervisory Mechanism. In addition, there was a view that consumer and investor protection is currently

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<sup>179</sup> The vast majority of EU Member State competent authorities receive some type of industry funding today.

dissipated between the individual ESAs, and having one conduct authority should facilitate the coherence of a pan-European policy.

### **Evaluating the coherence of the ESAs framework**

Since the start of the financial crisis, the EU and its Member States have engaged in a fundamental overhaul of financial regulation and supervision. The EU has initiated a number of reforms to create a safer, sounder, more transparent and responsible financial system that works for the economy and society as a whole. This has included the creation of the SSM and the SRM/SRB created for specific and discreet responsibilities. The ESAs Regulations are coherent with and complementary to those bodies.

On the regulatory side, the Single Rulebook was introduced and stakeholders have reported on the important role the ESAs have had in contributing to this work and the importance the ESAs will have also in the future to finalize the Single Rulebook. However, to fully benefit from the Single Rulebook, legal acts must be interpreted and applied in a convergent and consistent manner and compliance must be supervised in a consistent way. This is achieved through work on supervisory convergence across the EU. This is an area where stakeholder views converge strongly around the fact that notwithstanding efforts made by the ESAs in this area, much more can be done to improve supervisory convergence in the EU 28. Especially to promote the CMU and to provide a coordinated response to the shock of having the UK leave the EU which will test the ESAs ability to contribute to ensuring financial stability within the remaining Member States.

Overall, the ESAs framework is also coherent with the existing models of EU decentralised agencies while taking into account the specificities of the ESAs.

### **Evaluating the relevance of the ESAs framework**

The ESAs constitute a functional cornerstone of the comprehensive reform package put in place in recent years and they have played a key role in ensuring that the financial markets across the EU are well regulated, strong and stable.

Significant changes in furthering the EU's integrated financial framework have been made since the ESA's were last evaluated in 2014. The new capital requirements and resolution frameworks for banks<sup>180</sup> (2014) and the solvency framework for insurers<sup>181</sup> (2016) have entered into effect and contributed to a reinforcement of the Single Rule Book for financial services. The framework for banks in Member States participating in the Banking Union –

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<sup>180</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (OJ L 176, 27.6.2013, page 338); Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (OJ L 176, 27.6.2013, page 1); and Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (OJ L 173, 12.6.2014, page 190).

<sup>181</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, page 1).

currently the euro area but open to all Member States - has been reinforced with the creation of the Single Supervisory Mechanism ("SSM") and the Single Resolution Mechanism ("SRM"). The development of the CMU has also taken off to complete the single financial market and boost EU's capital markets in all EU Member States. More recently new challenges to financial integration have arisen as the United Kingdom has notified its intention to leave the EU. It is inevitable that these changes impact on the way the ESAs operate, including in a way that could not necessarily have been foreseen at the time when the ESAs were created.

Feedback from stakeholders confirm that the ESAs have carried out remarkable work contributing to the building of the Single Rulebook, to ensure a robust financial framework for the Single Market and to underpin the building of the Banking Union as part of the EMU. However, stakeholders responding to the CMU public consultation and to the ESA review consultation point to the fact that further progress in relation to especially supervisory convergence is needed to promote the CMU, integration within the EU's internal market for financial services and to safeguard financial stability.

The Commission also notes that in the area of capital markets in particular, the Five Presidents' Report of June 2015<sup>182</sup> outlined the need for further supervisory responsibilities in the area of capital markets as a vision for a well-functioning CMU, and the 2016 CMU Communication emphasised that further work will be needed to reinforce the European dimension of supervision. This was reemphasized in the Commission's Reflection paper on the deepening of the EMU.<sup>183</sup>

### **Evaluating the added value of the ESAs**

In terms of EU added value, the ESAs covered a significant gap in the supervisory framework in the EU Single Market as before the creation of the ESAs the system of micro-prudential supervision in the EU was nationally based; i.e., it was based on the principle of home country control combined with minimum prudential standards and mutual recognition. A nationally based supervisory system does not match the integrated and interconnected reality of the European financial markets in which many financial entities operate across borders.

With the creation of the ESAs it was acknowledged that there was a need for an EU-level supervisory system to enhance consumer and investor protection and sustainably reinforce the stability and effectiveness of the financial system throughout the EU. These objectives are better achieved at Union level.

As presented both in the Commission's 2014 evaluation and as evidenced by the responses to the public consultation on the ESA review, stakeholders agree that the ESAs have significantly contributed to strengthen coordination and cooperation among national supervisions and played a key role in ensuring that the financial markets across the EU are

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<sup>182</sup> [https://ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union\\_en](https://ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en)

<sup>183</sup> COM(2017) 291 of 31 May 2017



functioning in an orderly manner, are well regulated and supervised and consumers' protection is enhanced.

The need for the ESAs and their contributions to effective supervision across the EU will be even more important in light of the increasing interconnectedness of financial markets, EU and globally. The ESA will be at the heart of efforts to build CMU given the central role that they plays in promoting market integration and creating single market opportunities for financial entities and investors.

Going back to a nationally based supervisory framework based on the principle of home country control combined with minimum prudential standards and mutual recognition would simply not be able to deliver on the urgent needs to further integrate the EU financial markets and especially the capital markets framework. This would have a negative consequence on the EU's ability to strengthen long term investments and create funding sources for EU businesses which are necessary elements to strengthen the EU economy and stimulate investment to create jobs.

## Section 7 Conclusions

The overall objective of the ESAs is to sustainably reinforce the stability and effectiveness of the financial system throughout the EU while enhancing consumer and investor protection. This evaluation shows that based on available evidence, the ESAs are broadly delivering on their objectives but that there are targeted areas where improvements may be needed.

On the **effectiveness** and **efficiency** of the ESAs, the evaluation indicates that:

- in certain areas, the ESAs' powers could be enhanced to ensure that tasks can be better performed. As a result, better regulatory and supervisory outcomes for market participants and consumers across the EU, and effective and efficient handling of cross border risks could be expected;
- the current governance framework makes it difficult to manage conflicts between EU and national interests, implying the risk that ESA decisions are not taken in the common interest of the EU, that decision-making is delayed or that there is an inaction bias, notably as regards non-regulatory activities (binding mediation, breach of EU law procedures, initiation of peer reviews), the decision making process could be more swift, and the perceived bias against using certain tools and powers should be eliminated;
- the current funding framework is more effective vis-à-vis the baseline, but it is not commensurate to the tasks the ESAs perform and even less so going forward and considering the tasks the ESAs will shoulder in the future; it also seems to lead to uneven contributions by national competent authorities which are not easy to justify;
- the current sectoral supervisory architecture of the ESAs has been appropriate.

In terms of **coherence**, the ESAs work on regulatory issues is fully coherent with the building up of the broader EU supervisory framework. It is also coherent with the building up of the Single Rulebook. However, constraints coming from governance structure and the effectiveness of the ESAs powers have as a consequences that they the ESAs have not been able to sufficiently focus on work that ensures that all the financial legislation adopted by the EU is interpreted and applied in a convergent and consistent manner across all EU Member States.

In terms of **relevance**, the analysis concluded that the ESAs framework is relevant.

Finally, the ESAs' framework has clearly created **added value** for the **EU** because their work is indispensable for promoting the Single Market for financial services.

## 11.6 Background on the elements of direct supervision in Option 3 of chapter 6

### 1. Certain wholesale non-equity prospectuses, prospectuses for asset-backed securities and specialist issuers

The Prospectus Directive and the recently published Prospectus Regulation specify that prospectuses are approved by the national competent authority (CA) of the Home Member State of the issuer.<sup>184</sup> On the basis of a simple notification (passport) to the national CA of another Member State the securities can also be offered to the public or admitted to trading on a regulated market in that host Member State.

For a vast majority of the securities for which a prospectus is prepared there is a strong 'home bias' in the investors, i.e. a disproportionate share of them are offered exclusively in the Member State in which the prospectus is approved (no passport is requested by the issuer). This is particularly true for equity securities. However, there are prospectuses for certain types of non-equity securities and issuances where this does not hold, because the offer of securities is addressed to professional investors across the Union. This is the case for non-equity securities, of which some can be of a highly specialised nature:

1. Prospectuses for asset-backed securities (ABS). Despite being mainly concentrated in 9 countries within the EEA (with a prominent position of Ireland), the share of approved prospectuses for ABS is quite significant, accounting for about 12% of approved prospectuses for all types of securities.
2. Prospectuses by so-called specialist issuers (companies active in the exploration, processing and distribution of oil, gas or minerals, property companies): These companies often require idiosyncratic disclosures (e.g. available reserves, political context, etc.) where relevant sector expertise is required.
3. Prospectuses for wholesale non-equity which are typically prepared for the listing of debt securities on regulated markets or their segments, dedicated only to qualified investors<sup>185</sup>, following a private placement. Private placements are an important source of capital for issuers and are cross-border by nature. While a private placement with qualified investors does not require a prospectus, the subsequent admission to trading of the securities on a regulated market is subject to the publication of a prospectus.

### *Assessment*

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<sup>184</sup> As defined in Article 2(m) of Regulation (EU) 2017/1129

<sup>185</sup> While currently such regulated markets or their segments only for professional investors are not well-developed, they are expected to grow in the future, potentially amounting for a considerable share of non-equity prospectuses for professional investors.

Prospectuses falling in the above three categories are normally used to raise capital in several Member States, not only locally. In the first two cases because of the specific nature of the offers and in the third case because it is often the bigger companies using this technique in order to allow institutional investors like insurances and pension funds to invest in these products. In all cases there is a certain risk of regulatory arbitrage as the Prospectus Directive/Regulation provides certain flexibility in the choice as to where to get these prospectuses approved. The third criterion of a small scale would only apply to the specialist issuers. The other types are rather major or potentially major categories of issuers. The fourth criterion would not be fulfilled as all types already exist under the current Prospectus Directive, while the fifth criterion of limited retail exposure would apply fully to the wholesale non-equity prospectuses and broadly speaking also to the other types as the offers are directed to institutional investors and bigger investors.

## **2. Prospectuses drawn up by non-EU entities in accordance with Regulation (EU) 2017/1129**

Issuers from non-EU countries can offer their securities in the EU either using an EU prospectus in accordance with Regulation (EU) 2017/1129, which must be approved by a national CA in the EU (the CA of the home Member State of the non-EU issuer for the particular offer or admission), or by using a prospectus drawn up according to the national law of the third country provided that the supervisory and regulatory regime of that country has been considered equivalent by the European Commission in an implementing decision. The latter case, however, has not occurred yet. According to an ad-hoc survey in 2015, only 3 national CAs approved a total of 117 prospectuses from third country issuers in 2013 and 5 national CAs approved 119 such prospectuses in 2014; Luxemburg approving the lion share with 112 and 109 prospectuses, respectively.

### ***Assessment***

As prospectuses of third country issuers are usually used for fundraising in several Member States, there is therefore a clear EU dimension. As the vast majority is currently approved in Luxemburg, centralisation at ESMA will most likely not lead to efficiency gains. It would, however, eliminate the risk of forum-shopping. In view of the current practice and United Kingdom's exit from the Union, Luxemburg might be faced with a disproportionate workload and responsibility in the approval of third country prospectuses if there was no change in the system.

## **3. Critical benchmarks and benchmarks provided in a third country but used in the Union under the 'Benchmark Regulation'<sup>186</sup>**

The Benchmark Regulation (BMR) regulates the provision and the use of benchmarks in the Union. A benchmark is an index by reference to which the amount payable under a financial instrument or a financial contract, or the value of a financial instrument, is determined, or an

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<sup>186</sup> Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014

index that is used to measure the performance of an investment fund. As there are probably tens of thousands of benchmarks in the Union, the BMR differentiates between non-significant, significant and critical benchmarks.

A critical benchmark is a benchmark which is referenced in financial instruments, financial contracts or investment funds in the Union with a total value of more than EUR 500 bn or a benchmark which has no or very few market-led substitutes and the existence and accuracy of which are relevant for market integrity, financial stability or consumer protection in one or more Member States.

In addition to the general requirements of the BMR a number of specific requirements apply to critical benchmarks. If they are of importance in several Member States, they are not supervised by the national CA alone but by a college of supervisors. This college comprises at least the national CA of the administrator of the benchmark, the national CAs of the supervised contributors to the benchmark and ESMA. Other national CAs might request to become a member. As a college member, ESMA is considered to be a competent authority. The competent authority of an administrator chairs the meetings of the college, coordinates its actions and has to ensure an efficient exchange of information among members. Before taking any measures regarding mandatory contributions, authorisation or registration or the withdrawal thereof or administrative sanctions or measures the competent authority of an administrator has to consult the members of the college and has to take into account the impact on the other Member States. It can, however, decide on its own. If other college members disagree they can refer the question to ESMA and ESMA can give advice. Only in the case where there is disagreement about the application of mandatory contributions to the benchmark ESMA can make use of its mediation powers under Article 19 of the ESMA Regulation.

The BMR provides three alternative scenarios in which benchmarks provided by an administrator in a third country may be made accessible to supervised users in the EU:<sup>187</sup>

1. the Commission has adopted an **equivalence** decision regarding the legal framework and supervisory practice of that country, the administrator is subject to supervision in that country and has agreed that its benchmarks may be used by supervised entities in the Union, and ESMA has established a cooperation arrangement with the country's competent authority;
2. if equivalence has not been established, a benchmark provided by the administrator in the non-EU country can be used by supervised entities in the Union, provided that the administrator has obtained prior **recognition** by the competent authority of its Member State of reference. The latter requires that the administrator complies with the requirements of the BMR<sup>188</sup> and has a legal representative established in its Member State of reference; or

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<sup>187</sup> Articles 30-33 BMR

<sup>188</sup> With the exception of provisions which refer to administrators or supervised contributors in the Union.

3. a benchmark or a family of benchmarks provided in a non-EU country can be **endorsed** by a national competent authority for use in the Union. In such cases a supervised entity in the EU with a clear and well-defined role within the control or accountability framework of a non-EU country's administrator must apply to its CA for this endorsement and demonstrate on an ongoing basis that the provision of that benchmark fulfils requirements at least as stringent as those in the BMR. The supervised entity must have the necessary expertise to monitor effectively the activity of the providing a benchmark, and there has to be an objective reason to provide the benchmark in a non-EU country and to use it in the EU.

ESMA has different roles under the three scenarios outlined above:

Under the equivalence regime, ESMA is the point of contact in the EU. It establishes cooperation arrangements with the competent authorities of third countries, covering a mechanism for the exchange of information and for prompt notification procedures and the coordination of supervisory activities. Benchmark administrators from equivalent third countries have to inform ESMA of their consent of the use of their benchmarks in the Union.

Under the recognition regime, ESMA has only an advisory function relating to a minor aspect regarding the type of the benchmark and the requirements applicable to its provision. If the national CA does not follow this advice, ESMA has to publish this fact. ESMA also has to be notified of the recognition of the benchmark. In addition, ESAM may develop draft regulatory technical standards on the form and content of application for recognition of a benchmark and submit these for adoption to the Commission.

ESMA has no specific role in the endorsement of third country benchmarks except being notified by the CA of the endorsement (or its withdrawal) of the benchmark.

However, ESMA has to review all recognitions and endorsements every two years. ESMA will issue an opinion to each competent authority that has recognised a third country administrator or endorsed a third country benchmark assessing how that competent authority applies the relevant requirements. ESMA also runs a public register of benchmark administrators and third country benchmarks the use of which is permitted in the Union.

ESMA can withdraw the registration of a third country administrator by removing that administrator from the register where it has well-founded reasons, based on documented evidence, that acts by the administrator are prejudicial to the interests of the users of its benchmarks or the orderly functioning of markets or has seriously infringed the national legislation or other relevant provisions in the third country. It can take such decision only if the third country supervisor has not taken the necessary action and after having informed that supervisor of its intention.

### *Assessment*

Direct supervision of Union-wide critical benchmarks by ESMA would meet most of the criteria established above: Currently there are only two critical benchmarks in the Union: EURIBOR and EONIA. Both are of greatest importance for financial markets and financial

stability in the entire Union. As it is unlikely that there will be more than about a dozen of critical benchmarks, supervision of critical benchmarks by ESMA would not require many resources.

While both critical benchmarks are administered in Belgium, they use input data from contributing banks in around ten Member States and they are used in all Member States. Although the benchmarks are used in financial products which are used by retail investors and consumers, for example derivatives and mortgages, retail investors do not have direct dealings with the administrator.

Furthermore, the BMR will only be applicable as of January 2018. Currently, only the specific provisions for critical benchmarks are applicable. Therefore, national CAs, with the exemption of the UK FCA and, as supervisor of EONIA and EURIBOR, the Belgian FSMA, do not have any experience in supervising benchmarks.

Only the criterion regarding regulatory arbitrage would not fully apply as the administrators of such big benchmarks are long established and would be unlikely to move their business for that purpose only.

As regards third country benchmarks, their provision/use will by definition be across borders and the determination of the relevant supervisor is to some extent both arbitrary and prone to manipulation, i.e. there is a considerable risk of regulatory arbitrage. The number of third country benchmarks will most likely be very large, especially after the United Kingdom has left the EU. Supervision of these benchmarks by ESMA would therefore require considerable resources but would nevertheless be efficient as only one CA would have to deal with foreign regulatory regimes, supervisors and entities in foreign languages. In addition, ESMA has already a number of functions with regard to the supervision of third country benchmark administrators and has established contacts with many third country supervisors.

As explained above the BMR is still not applicable and retail investors or consumers do not have much direct contact with benchmark administrators.

#### **4. Direct supervision of certain types of Data Reporting Service provider under MiFID II and enhanced data gathering powers.**

Effective supervision of investment firms by the national competent authorities in cooperation with ESMA depends on the level of information they have on what happens in the markets. Supervisors get information from market participants on the basis of reporting requirements set out in various pieces of legislation. Notably, trade reports are submitted by market participants on daily basis, which serve as input into national surveillance systems for analysis and exchanges between competent authorities. The information on transaction reports submitted by investment firms to the competent authorities is the essential core data used for market abuse surveillance. Hence, standardised high-quality trading data is required.

In this regard, one of the aims pursued in the first iteration of MiFID<sup>189</sup> was to increase choice in executing trades in financial instruments and reduce the cost for doing so. One of the issues not addressed in MiFID I was the monitoring and reconstruction of trading data. This led to EU trading data that was neither consistent nor of adequate quality to monitor whether the aim of MiFID has been met. In addition, trading data was not made available at reasonable cost throughout the EU by the relevant trading venues. Inconsistencies in quality, formatting, reliability and cost can have a detrimental effect on data transparency, investor protection and market efficiency.

The revised MiFID text, MiFID II<sup>190</sup>, will be applicable as of 3 January 2018. It is intended to resolve these issues by improving the quality and accessibility of trading data. It will do so by:

- setting a standard format for trading data that will be easy to consolidate, readily understood and available at a reasonable cost;
- requiring data providers to be authorised by their national CAs and imposing formal organisational requirements on them; and
- seeking to encourage private sector providers to offer consolidated trading data that covers all trades in equities or non-equities throughout the entire EU.

MiFID II therefore creates a new regulatory framework for data reporting services providers (DRSPs):

- post-trade data reporting services will need to be authorised as approved publication arrangements (APAs);
- a firm that provides a consolidated tape will need to be authorised as a consolidated tape provider (CTP);
- MiFID II will formalise transaction reporting channels to the national CAs by requiring third parties that report on behalf of firms to be authorised as approved reporting mechanisms (ARMs).

These entities will be supervised for these purposes for the first time as these activities were mostly unregulated at national level.

A closely associated issue to the authorisation and supervision of DRSPs is the collection of trading data. Under the current system foreseen under MiFID II, for this purpose, there is an obligation for the designated NCAs to collect data from trading venues on a high number of financial instruments throughout the EU. Under the current system each NCA must gather

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<sup>189</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC

<sup>190</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU



data from multiple operators throughout the EU and then transmit it to ESMA for compilation and analysis. In turn ESMA then provides compiled data back to the competent authorities; data which serve as a basis for transaction reports (reference data). Furthermore, based on trading volumes provided by NCAs ESMA also sets various thresholds used in the application of trade transparency requirements.

The current proposal consists of conferring the powers to gather the above data directly from market operators from competent authorities to ESMA. This would end the current sub-optimal (at legal) situation of multiple-to-multiple points of data distribution. This would help achieve the very purpose for which ESMA has been established, i.e. to ensure that national supervisors perform their day-to-day supervisory tasks effectively and in a consistent manner across the EU, that they give convergent interpretations of the same EU rules, and that supervisors arrive at the best possible supervisory decisions for cross-border financial market participants to ensure orderly markets, financial stability and investor protection. Information-sharing is a necessary precondition for effective supervisory action. It would also make it easier and more efficient for market participants to fulfil their reporting obligations. The need for more centralisation of data gathering was already acknowledged by competent authorities, the majority of which therefore delegated these tasks to ESMA in accordance with the ESMA regulation (Financial Instruments Reference Data project (FIRDS)).

### *Assessment*

As the above rules have not yet entered into application, no concrete problem can be identified at this stage. However, most national CAs have delegated to ESMA the significant essential data handling to fulfil requirements and set thresholds in relation to MIFID trade and transaction data. This fact shows that there is room for achieving economies of scale. Enhancing ESMA's supervisory powers would be an extension and consolidation of the trend of pooling "data" matters with ESMA.

Given the cross border dimension of data handling, transferring supervisory powers to ESMA in this connection could prove beneficial. Trading data is an increasingly essential tool for effective enforcement which means that the more data savvy an authority is the better equipped it is for also taking on supervisory responsibilities in different areas.

Assessing the supervision of data providers against the above criteria confirms that view: The data handled by these data providers is extremely important and used by market participants and CAs across the Union. It is not expected that there will be a very great number of these entities, and it is expected that they will not evenly spread among Member States. The entities come under supervision for that purpose for the first time and their data is not mainly being used directly by retail investors or consumers.

Finally, by making the data gathering an ESMA responsibility (and not only a delegated task from the NCAs as is currently the case), there will be legal certainty as ESMA will have a clear mandate to be the EU central hub for data gathering. This will enable it to build and further adapt the system in view of changing market conditions and ensure high data quality.

NCAAs will be able to focus on enforcement and market participants would benefit from a streamlined one-stop-shop data collection system.

## **5. Direct supervision of EU standardised EuVECA/EuSEF and ELTIF funds**

Whilst the UCITS and AIFMD Directives comprise minimum harmonisation requirements and allow for several national discretions, the EuVECA/EuSEF and ELTIF (and most recently MMF<sup>191</sup>) Regulations provide for a standardisation of product/fund rules. However, the interpretation and application of the EuVECA/EuSEF and ELTIF Regulations as well as supervisory responsibility remain at national level: irrespective of the level of achieved harmonization through standardisation, ESMA merely exercises a coordinating and advisory role, and seeks to promote convergence of supervisory practices and transparency through existing powers conferred to it.

### **Assessment**

The UCITS and AIFMD Directives build on the supervisory structures developed with an established ongoing supervisory convergence. The Directives allow for several national discretions, in particular with respect to the investor protection.

In the absence of detailed standardised product/fund rules for UCITS and AIFs at EU level, it appears as practically very difficult to confer the powers of direct supervision to ESMA in this regard. As MMFs take form of either AIFs or UCITS, thus in the latter group UCITS product rules apply, the supervisor needs to apply national UCITS implementing rules. In addition, according to ESMA data, there are, around 1400 UCITS and 2400 AIF managers, therefore, transferring supervisory tasks to ESMA over all managers would require considerable resources and might disrupt the proper supervision and enforcement during at least a transitional period.

The situation of EuVECA/EuSEF and ELTIF funds differs. Their fund rules are fully standardised. They have been created especially to promote cross-border fund raising. As the EUVECA and EUSEF Regulations and the ELTIF Regulation apply since 2013 and 2015 respectively, the total number of funds is still relatively small (around 120 EuVECAs, up to 10 EuSEFs and ELTIFs). Furthermore, EuVECAs and EuSEFs are only available to professional investors and high net worth individuals.<sup>192</sup> ELTIFs are also available to non-professionals, however, with some sizable restrictions.

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<sup>191</sup> Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds, OJ L 169, 30.6.2017, p. 8–45.

<sup>192</sup> Non-professional investors investing at least €100.000.