HMT's Review of the Balance of Competences

Single Market: Financial services and the Free Movement of Capital

Response by the Association for Financial Markets in Europe

A. Introduction

1. The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the review of the Balance of Competences Review. AFME represents a broad array of European and global participants in the wholesale financial markets. Its Members comprise pan-European Union ("EU") and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. Our perspective, which – importantly – stems from a focus on the wholesale markets, draws on the European experience of our Members, and so gives us the scope to provide unique insights on financial services policy making in Europe.

2. AFME is a European trade association, but given the importance of the UK markets, both to the European Union as a whole and to the many EU and international firms that have operations in, or provide services on a cross-border basis into the UK, we consider it important to engage proactively and constructively in national debates that determine the environment in which our Members undertake their business. In responding to this Balance of Competences Call for Evidence we have drawn on the key messages from our Members on their priorities at large in Europe together with the issues concerning the framework within which financial services policy is determined and with which we are currently dealing.

3. AFME advocates stable, competitive, sustainable European financial markets that support economic growth and benefit society. A key priority, therefore, for our Members is

maintaining and improving the single financial market in Europe. We support deep integration of the financial markets: the type of integration that goes beyond the right to offer cross-border financial services – important as that is, though, as we note further below – and seeks to eliminate all potential obstacles to cross-border trade.

4. The ability for financial services to flow freely amongst jurisdictions is a fundamental benefit in the efficient allocation of capital to the economy. We consider that the fewer the obstacles to the flow of trade and services, and the greater the degree of integration, the better our Members are able to serve their clients and the economy. Acknowledging that regulation is necessary in order to preserve financial stability and protect consumers, we consider that a regulatory environment which lacks such deep integration will give rise to fragmentation and significant barriers to trade (such outcomes resulting from both prudential and conduct regulation in themselves and also from their possible use as a disguised form of protectionism) and there are concerns about the extent to which in practice national boundaries have emerged in the operation of financial services markets in the wake of the crisis.

5. We would note, additionally, that as well as its role in providing financial services throughout Europe, London is of course an international financial centre, so that the EU regulatory rules determine the scope for firms to cater to the needs of their clients worldwide. This submission does not focus on this aspect, given the questions raised in the Call for Evidence, but it is important that the point is not lost sight of in examining the issues raised in the wider context of this Review.

B. The importance of the single market for financial services (and the additional measures that would enable its optimal functioning)

6. A key element in considering the balance of competences within the EU as regards the rules dealing with the provision of financial services is to recognise the wider picture - the importance of the single market to the European economy. We welcome, therefore, the helpful summary provided in HMT's Paper (at paragraphs 1.19 – 1.26) on the importance of the financial services market to the UK economy.

7. By definition the goal of establishing the single market in financial services has entailed a structure which allows common rules to be developed – but has the balance between rule making at the centre and maintaining national discretion been satisfactorily struck? We consider that in helping to answer this question it is most helpful for AFME to highlight the extent to which, historically, a single market in wholesale financial services – the business which we represent – has been made possible by the "passporting" provisions in the various directives, together with the measures requiring the abolition of exchange controls, thus freeing capital movements. This regime has been particularly important for London as a financial centre, opening the door to the provision of a range of services across Europe.

8. However, in our view there are still elements that are missing before the optimal regulatory regime can be established, comprising measures that will best enable financial services firms to meet their clients' needs. In particular, we perceive the need for:

    a. a single rulebook, with a strong role for the EBA in this regard;

    b. a role for the ESAs in enabling strongly integrated supervision which avoids duplication or inconsistencies leading to distortions – thus the development of the European

Supervisory Handbooks (while we believe that there will always be an essential role for supervisory judgment and discretion, there should be no difference in the *rules* applying in the 28 EU Member States);

c. a strong binding mediation role for the ESAs;

d. the use of Regulations over Directives wherever possible;

e. effective cross-border resolution frameworks which put an end to national ring-fencing incentives; and

f. a regime which doesn't deny access to third countries, thus the need for an equivalence assessment system which works.

9. Broadly, this is best achieved within a legislative/administrative architecture that flexes according to the regulatory demands that firms have to follow, and would benefit from a Community (as opposed to inter-governmental) approach to regulatory rule-making.

10. Overall, in assessing the balance of competences, it is important to acknowledge that the basic architecture for making the rules has generally been fit for purpose, and continues to have a key role. But there is more – and important – work to be done: there are elements of the current structure which need to be improved.

11. Such is the context which has determined our approach in responding to the particular issues that our Members have asked us to address within the Call for Evidence: essentially, we considered the important features of the legal framework in which the EU rules that apply to capital markets activities are determined and we then focussed on some areas where experience suggests that improvements should be sought.

12. The remainder of this submission focuses on this aspect. Our particular questions relate to the operation of the European System of Financial Services (ESFS) – and principally the operation of the European Supervisory Authorities – a matter of growing importance given the extent to which the move to legislation by Regulation (rather than by Directive) limits the scope for national rule making: our underlying purpose is to assess the division of responsibilities between the EU and national regulatory bodies so as to provide the optimum regulatory environment for firms to serve their customers.

C. The role of the ESFS and the scope for improved procedures

13. The ESFS was established in 2011. Whilst this period constitutes a rather tight timescale to allow any final judgment on the functioning of the framework and of the three European Supervisory Authorities ("ESAs"), the fact that they have been established and have had to operate during a period of crisis has facilitated a preliminary assessment and resulted in the identification of areas where improvements should be made.

14. In the context of HMT's Balance of Competences Review of the Single Market for Financial Services, a central question remains: what is the optimum regulatory environment in which firms in the Single Market can thrive and can best serve consumers and investors? AFME believes that the current ESFS, whilst it is a significant improvement on its predecessor, does not function as well as it could. Important modifications are desirable and necessary in order

to achieve the objectives of the system and to improve the manner in which it supports integration of European financial markets and the functioning of the European economy.

15. In particular, we present four significant areas that AFME believes would benefit from improvement, which cover the activity of the ESAs and the realm of macroprudential supervision:

    - Consolidating and enhancing the capacity of the ESAs;
    - Rebalancing the ESAs' work;
    - Improving the rule-making process;
    - Enhancing the macroprudential supervision framework.

16. Below, we detail each area. But before doing so, and as regards ESMA, we would draw HMT's attention to the comments submitted by ESMA (31 Oct 2013) to the EU Commission, setting out its views on the ways in which the current ESFS can be improved. In this letter, Steven Maijoor, chair of ESMA, urges the Commission to consider, amongst other things: increasing the funding ESMA receives from entities which require its intervention; taking the necessary measures to finance the ESAs through an independent budget line within the Union budget; ensuring that the Level 1 legislative process takes into account the timetable needed for Level 2 developments; and empowering ESMA temporarily to suspend the application of particular rules in relevant circumstances (comparable to the US equivalent of 'no action relief').

17. AFME, drawing on our Members' experience, consider that these observations are well made, as will be reflected in the comments that follow.

Consolidating and enhancing the capacity of the ESAs

18. While important progress has been made since the establishment of the ESAs, particularly in the regulatory field, much remains to be done.

    a. AFME believes that the leadership capacity of the ESAs is central and would be enhanced by strengthening their independence – including their independence from the European Commission and from national authorities. There are a number of issues that we have been considering at this stage. Given the limited time available to consult in detail with our Members on some aspects, we limit our recommendations to encouraging the exploration of possible governance reforms to achieve greater independence and effectiveness in a variety of ways, including:

        i. Granting voting rights to the Chair for decisions adopted by the Board of Supervisors ("BoS"), in cases of decisions that are based on "one member, one vote";

        ii. Considering possible governance reforms that could distinguish regulatory and other tasks, such as direct supervision and convergence in supervisory practices, while also assessing the current role and composition of the Management Board and exploring proposals to expand its role and powers. Among the possible ideas that could be further explored are the transformation of the Management Board into an Executive Board composed of five full-time individuals and entrusted with specific new competences and powers, including:

- Making decisions on directly supervised entities (if any);
- Adopting decisions on supervisory convergence, such as peer-reviews, mediation, breaches of EU law, and actions in emergency situations;
- Making decisions that are to be adopted under very short deadlines (for instance, the decisions to be adopted by the European Securities and Market Authority ("ESMA") under the Short Selling Regulation ("SSR")); and
- Preparing for meetings of the BoS.

iii. Reforming the composition of the BoS by making the members of the Executive Board full members of the BoS and granting them voting rights, in cases of decisions based on "one member, one vote".

In order to realise the potential of the ESAs, there should be a greater level of financial independence from the European Commission and from national authorities. One possible option is that the EU makes a larger contribution to ESAs from its own budget, rather than require significant funding from national authorities, together with the creation of a specific budget line in the Community budget.

b. The ESAs' role in helping deliver an international level playing field for financial services should be significantly enhanced. This includes providing them with the resources and authority to take the leading role in equivalence determinations, relevant international discussions, and cross-border convergence. A proposal for enhancing the leadership capacity of the ESAs in international discussions could include entrusting the ESAs with adequate powers to ensure that they have the ability to interact at arm's length with third-country regulators (for example, by giving a leading role in the EU-US Financial Market Regulatory Dialogue, and enhancing their visibility and "voice" in international bodies).

c. The leadership capacity of the ESAs, within and outside of the EU, should be enhanced by providing them with the resources necessary to fulfil their tasks. We believe that the ESAs' resource allocations should be increased considerably. This is necessary in order to develop high-quality rulebooks and to make necessary advances on the other objectives of the ESAs, including supervisory convergence, peer reviews, mediation, strong participation in supervisory colleges, and addressing breaches of EU law. It is also recommended that the ESAs actively recruit staff with seniority and markets experience, so as to enhance their depth of expertise and increase the authority of their contributions.

Rebalancing the ESAs' work

19. The ESAs have been entrusted to discharge a range of unique and separate tasks. However, an analysis of their first two years of existence suggests that to date, the achievements of the ESAs have had a greater impact in the area of rulemaking than in respect of their other objectives which include the convergence of supervisory practices, mediation, participation in supervisory colleges, and addressing breaches of EU law.

20. Establishing the convergence of supervisory practices is an important and challenging task, especially given the existence of diverging national interests. AFME encourages the ESAs to use available instruments to strengthen convergence in supervisory practices. This should include the development of a comprehensive and coherent corpus of material articulating to an advanced level of detail the purpose, mode, approach, and manner of supervision of the full range of financial services issues and promoting a consistent supervisory culture. The Single Supervisory Handbook to be developed by the EBA under the banking union legislation is an important new formalised feature of the landscape in this regard. AFME attaches great importance to this issue. We believe that it needs strong resourcing.

21. The ESAs should conduct more peer reviews exclusively with ESA staff. Consideration should be given to entrusting the newly established Executive Board (as we propose) with their approval and to the possibility of publishing results as a mechanism to drive change. On the latter, further discussion should be conducted to enhance the effectiveness of peer reviews, particularly focused on whether it is preferable to always request the publication or instead allow a certain degree of flexibility.

22. There should be proactive use of mediation in all areas covered by EU law falling under the competences of the ESAs.

Improving the rule-making process

23. AFME reiterates that the underlying process of financial regulation development should be based on the following principles: clarity, efficiency, openness, transparency and evaluation. The Level 1-Level 2 relationship has not functioned as it should in many cases and this aspect needs to be addressed urgently.

24. We believe that the following proposals would considerably improve the rule making process.

    a. We encourage greater clarity and certainty in Level 1 texts and in mandates for the development of Level 2 rules. One possible way to achieve this would be for the Commission and the Co-legislators to adopt an Inter-Institutional Agreement setting out the agreed principles that should be respected by any provision requiring the adoption of technical implementation standards and by the mandates given to the ESAs to prepare the draft standards;

    b. We encourage the exploration of techniques to ensure that appropriate time is available for rule-writing and testing during the development of new rules or guidance, such as:

        i. Allowing participation of the ESAs' representatives as observers in technical discussions during the negotiations of the adoption of new legislative measures (such as Working Groups of the Council);

        ii. Asking the ESAs' estimate of the time necessary for the delivery of their technical standards and for their effective implementation by market participants and accepting such estimate;

        iii. Involving the ESAs in the preparation of the EC's mandates; and

        iv. Allowing the ESAs, when they have found deadlines to be too tight to be met, to implement a mechanism for suspension and pause in the process;

(By way of example, recent experience of the European Market Infrastructure Regulation has highlighted such challenges where timing and implementation are concerned.)

c. We emphasise the importance of:

i. Impact assessment including cost benefit analysis where appropriate, in fundamental parts of rule-making; and

ii. A robust dialogue with relevant stakeholders.

25. Impact analysis could be improved by conducting cumulative impact assessments. The dialogue with market participants could be further improved by organising it into two distinct layers: the high-level representation of wide interests that can be obtained and structured within the Stakeholder Groups and a technical dialogue that would benefit from the expertise in specific practices areas. Possible solutions include reviewing the selection criteria and process for member appointment of the Stakeholder Groups and, drawing from the positive experience of the groups established by ESMA, more systematically involving technical consultative groups and experts in the relevant areas of activity. While interactions between Stakeholder Groups and ESAs are important, these should neither be taken as a substitute for public consultation, nor as exhausting the technical dialogue with market participants.

26. An important challenge for the ESAs is to ensure that the development of a Single European Rulebook does not become confused with undue prescriptiveness. While eliminating unjustified differences between the rules applying in different jurisdictions is essential, this is a different matter from reducing the role of supervisory judgement. Sound and well-functioning financial services supporting the economy require a combination of strong and effective regulation with high-quality supervision incorporating a significant role for supervisory assessment and judgement.

Enhancing the macroprudential supervision framework

27. Whether the European Systemic Risk Board ("ESRB") has correctly fulfilled its mandate is difficult to assess, since macroprudential supervision is a relatively new topic that experts still debate and no relevant criterion or benchmark is currently available as a performance metric. Furthermore, we expect that the creation of the Single Supervisory Mechanism ("SSM") will have important consequences upon the macroprudential supervision framework for banking in the euro area. There is a need for further debate, beyond the limited time frame provided by this consultation, on achieving optimal macroprudential supervision in Europe.

28. Notwithstanding this need, AFME would encourage the review of the following elements:

a. An increased focus on "external" dialogue with financial firms to better identify potential sources of systemic risk, as well as other areas of activity related to the ESRB;

b. Strengthening and simplifying the governance of the ESRB. Among the possible options to be considered are the appointment of a full-time Chair or Managing Director who can speak on behalf of the ESRB and support the ESRB in day-to-day activity and enhance

the role of the Steering Committee, as opposed to the General Board; and

c. Clarifying the role of the ESRB vis-à-vis the ECB. The respective roles and mode of cooperation between the SSM and the ESRB in macroprudential areas should be clarified to address overlapping functions and cross-sectoral issues. Greater involvement and coordination of macroprudential decisions should also be considered, in particular, with countries not joining the SSM.

D. Concluding remarks

29. In light of HMT's stated aim to collect evidence which will enable an informed assessment of the UK/EU Balance of Competences, AFME hopes that this initial assessment will assist in the identification of the functional areas of the ESFS which work well, and others where improvements should be sought. Further to this, we have included a catalogue of examples of practices in the rulemaking process based on our Members' experience (**Appendix 1**), and a summary of ESA key facts (**Appendix 2**) which we hope will elucidate and contextualise the aforementioned issues raised on the functioning of the regulatory agencies.

30. Further analysis would be necessary to develop some of the proposals made, so AFME and its Members stand ready to contribute further to this Review.

31. We would be pleased, of course, to discuss the issues covered in this submission with the Treasury or to provide further information about any of the matters which our Members have raised if that would be helpful.

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APPENDICES

Appendix 1 – Rulemaking Process: examples of practices highlighted by Members

To try and provide some helpful material drawn from the recent period to illustrate and support the views expressed in this response, this Appendix sets out a number of examples relating to the implementation process of Level 1 provisions. We include examples and aspects which we believe represent positive models for future efforts, and others where the results were far from optimal.

Among the sound practices, we identify the implementation of:

Q&As: AFME recognises that the Frequently Asked Question ("FAQ") process is particularly useful. ESMA has set an example of good practices by widening the process to the industry and regularly calling for new questions. Contrariwise, the EBA's approach has been noticeably different. Our comments below reflect this as an example of concerns about some of the practices adopted.

Public Hearings: AFME values the organisation of Public Hearings by the ESAs and considers them to be particularly useful.

Accessibility and communication: The use of public speeches and other modes of communication can be helpful and useful. In a number of cases the ESAs have done a very good job in this respect, including senior staff speaking at regulatory as well as various industry events, together with communications through websites and other outlets.

Technical Consultative Groups: AFME recognises the productive technical dialogue established within the consultative groups established by the ESAs in certain areas, and the contribution made by various participants to the development of quality measures. AFME would welcome the opportunity for enhanced technical dialogue with specialist sub-groups of Stakeholder Committees, in addition to a revision of the current membership of the ESBR's ASC.

Central Securities Depository Regulation ("CSDR"): Members of the industry had been invited by ESMA to outline and explain their position on key items of this regulation at an early stage, as ESMA preparing its work at Level 2. This is a helpful approach contributing both to timeliness and to achieving appropriate levels of technical input.

MIFID/R: AFME considers that ESMA and its staff appear comparatively well organised in terms of planning for Level 2 processes in this proposed directive and regulation. This is important and welcome as there are many key issues at Level 2, for example the calibration of pre and post-trade reporting requirements, which will have a material impact on secondary market liquidity in various product areas. ESMA has been particularly very engaged with the transparency issues for fixed income as part of MIFID. There has been openness to consultation with industry stakeholders and to understand the workings of the industry.

In the context of the implementation of MIFID/R, it will be important that ESMA has sufficient resources either of its own or based on the ability to outsource to support and maintain the centralised infrastructure in Europe necessary to carry out core central functions (e.g. calibrating the transparency requirements for hundreds of thousands of fixed income securities).

Securitisation Disclosure Issues: ESMA had conducted a constructive public hearing where it solicited industry views on the implications of Article 8b Regulation 1060/2009 concerning securitisation issuer reporting requirements, which overlap with existing legislation and, if not appropriately delineated in scope, risk creating unnecessary and overlapping compliance and investor confusion in this important real economy sector. AFME also appreciates the opportunity for further regular dialogue with ESMA that has taken place since then.

Among the regulatory activities that, for various reasons, may be qualified as having been less than optimal and where there are lessons to be learned for the future, we would note the following:

EBA Q&As: The EBA has instigated what appears to be an ineffective and inflexible Q&A process for dealing with questions on the Level 1 CRDIV text. The regulator has made very slow progress in answering questions and, despite requests, the EBA appears reluctant to engage with industry on fundamental and important questions that do not fit its administrative template.

Short-selling Regulation (SSR): The implementation of the Short Selling Regulation provides clear examples of shortcomings in the implementation of Level 1 provisions, as well as illustrating some of our observations on the functioning of the ESAs and the importance of their independence.

The Regulation came into effect on the 1 November 2012. However ESMA had not finalised its Guidelines until 2 June 2013 (after being published in February 2013). It is very important that realistic timescales be provided in Level 1 texts which allow sufficient time for the ESAs to consult and develop Level 2/3 materials and market participants to adapt to the requirements.

The SSR is also a case in point regarding the significant challenges posed by inconsistent interpretation of Level 1 texts. Market participants raised important concerns regarding the narrow interpretation of the exemption available in the Level 1 text for market making and primary market operations for the purposes of the ESMA Level 3 Guidelines. AFME and ISDA presented detailed, independent legal analysis of the Level 1 text, but there was not the possibility to consider the legal analysis understood to have been underpinning the interpretation adopted in the ESMA Guidelines.

Five member states notified ESMA that they did not intend to comply in full with the Guidelines as a consequence of the interpretation adopted on the basis of analysis provided by the Commission. ESMA subsequently provided technical advice to the Commission in the context of the evaluation of the SSR, which reflected a number of concerns expressed by market participants regarding the negative impact of the application of the market making exemption and the ESMA Guidelines.

AFME and ISDA wrote jointly to the Commission in September 2013 supporting some of ESMA's points in its technical advice, and adding others. No response was received, but in December 2013 the Commission published a report on the SSR and the Guidelines (which ought, strictly speaking, to have been published in June). Far from acknowledging the shortfalls in the process and in the Regulation, the Commission appears to have taken the view that there is no issue with the drafting or the implementation of this Regulation, and have stated that they will not review it until 2016. They also comment adversely on the actions of those member states who have not complied in full with the Guidelines.

This provides a clear example of the difficulties and sub-optimality that can result in the absence of a well-structured, transparent and consistent Level 1-Level 2 nexus based on appropriate levels of clarity and certainty, operating to a sensible timetable and taking account of well-argued views of a minority of member states.

AIFMD (ESMA): AIFMD provided a further important illustration of the problems that can arise due to disjunctions in the Level 1-Level 2 interface. Neither in the Level 1 text nor in the ESMA recommendations was there an indication that the outsourcing models widely used by Managers across the EU were problematic. But, in the proposed Level 2 delegated act, the EC subsequently proposed restrictions on outsourcing that would have been highly damaging. This was eventually later amended, following objections by EU Member States and some Members of the European Parliament ("MEPs").

CRAs: The experience in respect of the CRA3 legislation provides further useful examples of the difficulties that can arise where the Level1-Level 2 nexus is not appropriately clear and where timescales are too tight. There was a general industry-wide understanding that the endorsement framework under CRA3 was created to provide a flexible mechanism to allow the continued use of ratings from non-EU jurisdictions, provided certain conditions were met by the rating entities. However, ESMA took the approach of widening the scope of the endorsement requirement so that "law or regulation" in the third country was required to achieve endorsement. The issue was particularly serious, as there was a hard deadline of 7 June 2011 in the Regulation, as a result of which, if endorsement was not achieved, a non EU- based bank would no longer be able to rely on its credit ratings which would have had potentially very severe adverse consequences for its capital calculations. While ESMA did take steps to try and communicate in a difficult context, at the same time there were examples of consultations with unreasonably short response periods and of late-stage uncertainty in the industry.

EMIR: Beyond the overall positive feedback of the implementation of the complex and innovative regulatory framework of EMIR, there is a belief amongst AFME Members that the approach to the issue of the authorisation of third country central counterparties ("CCPs") had been suboptimal. The industry faced a relatively short time period in which to convince third country CCPs to apply for authorisation. Otherwise, Members would have faced the prospect of establishing different structures enabling them to continue trading in markets other than those for OTC derivatives and Euro based securities. Our view is that this problem has arisen largely from a flaw of the Level 1 text. At the same time, with more resources ESMA may have been able to undertake wider stakeholder engagement, including some with third country CCPs and regulators.

Another practical challenge which industry participants continue to face under EMIR is the ambitious timescales for the implementation of reporting requirements, despite ESMA taking the unusual step of requesting a delay from the Commission.

Securitisation risk retention (EBA): The industry noted a lack of transparency in procedure in this particular area. The primary text on risk retention (which the industry supported) relied heavily for its interpretation on guidance issued by CEBS and the EBA; it did not change significantly between the Second Capital Requirements Directive ("CRD2") and CRR4. Because the industry was not aware that these guidelines would be removed and because the primary text remained largely unchanged, the industry proposed few alterations to the primary text suggested during the transition to the CRR. The industry feels that, had it known the guidelines were to be removed, a different approach would have been taken and changes would have been suggested to the primary text itself.

Securitisation (EBA): In many cases securitisation regulation will be significantly impacted by the views of the EBA, since most European securitisations are implemented by banks. Examples include not only risk retention, but also other important issues such as eligibility of securitisations for bank liquidity portfolios, the capital treatment of retained securitisation positions (for example, through the supervisory formula approach), trading book capital treatment and other issues. These issues all interact with each other and have a material impact on the motivation of banks to securitise real economy assets, so further loans can be generated. Given the breadth and complexity of the issues and their fundamental importance for the future funding of the European

economy, it is recommended that the EBA consider whether there may be the need to hire an increased number of staff with direct securitisation technical experience, or otherwise resource enhanced needs in this area. This would also help the EBA in discussions with other international bodies such as the FSB, BCBS and others on development of well-coordinated global securitisation regulatory policies.

Solvency II (EIOPA): EIOPA has been working on reviewing capital charges for securitisation under Solvency II. In this respect, we believe that EIOPA should have a clear mandate to independently ensure a consistent regime (e.g. calculated in a consistent way) across all financial instrument categories, whether securitisation (including between various securitisation asset classes), government bonds, bank debt, covered bonds and others; we stress that this is currently not the case and the proposed regime appears disproportionate. Further, we recommend that EIOPA would benefit from having additional staff with investment or markets experience on various assets classes invested in by EU insurers within the organisation.

In our interaction with EIOPA, we believe that EIOPA has been effective in consulting industry stakeholders and has been, to date, objective and empirically focused. Further, we have found their consultative processes transparent and clear.

Bank stress Testing (EBA): Given their importance, it is believed that it is also important to seek to draw lessons in respect of the stress tests that have been carried out. With reference to the past stress test exercises initiated and coordinated by EBA, the industry acknowledges that these have been important instruments in assessing the capital adequacy of the European banking system. It is acknowledged that the EBA went to significant efforts to standardise the results of its stress tests through, amongst other things, the use of pre-defined templates for all participating banks. However, specifically for the assessed banks, there are some aspects that could have been addressed more clearly, the result of which would have been to achieve a higher degree of comparability between the results. Amongst these aspects are the following, which should not be read as an exhaustive list:

- The introduction of changes in criteria during the process should have been avoided;
- Keeping in mind the novelty and tight timeframe of the exercise, banks would have been aided by having greater direct access (e.g., hotline service, email) to the EBA contact persons;
- Peer analysis was introduced late in the process;
- The EBA stress test exercise lacked a proper, solid legal basis that would have allowed for more direct and accurate control of the quality of data submitted.

Appendix 2 – ESAs: Key Facts

1. The governance structure of the ESAs consists of:

   a. A Board of Supervisors (BoS), composed of the heads of the 28 National Competent Authority ("NCAs") in each Member State, which constitutes the decision-making body;

   b. A Management Board, composed of six members selected from the BoS, focusing on the management aspects of the Authority, such as the development of the annual work program, budget and resources;

   c. A chairperson, who is responsible for preparing the work of the BoS and participates in the BoS meeting but has no voting right;

   d. An Executive Director supporting the work of the ESAs' staff; and

   e. A Joint Board of Appeal composed of two experts from each sector.

   In addition, internal standing committees and other working groups – comprised of staff from the NCAs – conduct the preparatory work for the ESAs' decisions. NCAs lead the work for the standing committees, while the ESAs' staff acts as rapporteurs.

   The Board of Appeal made its first decision in an appeal brought forth by an Estonian company against a decision of the EBA.

   During meetings of the BoS, the Chair represents the position of the Authority. Analysis of activity shows each ESA's Board of Supervisors met six or seven times per year, with strong levels of representation (mostly the designated members of NCAs).

2. The internal decision-making process is based on the following principles:

   a. At the level of the BoS, a decision requires a majority – either simple or qualified (for regulatory activity such as the adoption of technical standards) – with the assignment of one vote per member, the ESAs' Chairperson has no voting right; and

   b. At the level of the Management Board, decisions are adopted on the basis of a majority of the members present, each having one vote, with the Chairperson casting a vote only in the event of a tie.

   c. Whilst there is no evidence of voting results, public declarations by the Chair of the ESAs (Steven Maijoor) refer to the frequent use of the qualified majority voting that facilitates the adoption of decisions.

3. Budget and staffing. Currently, ESAs' funding is based on different models:

   a. Budget of EBA and EIOPA constitute part of the overall EU Commission's budget, with 40% coming from the EC section and 60% coming from the NCAs; and

   b. ESMA uses a different model with three sources of funding: a subsidy from the EC (46%), a contribution from the NCAs (30%) and a fee levied on CRAs under its direct supervision (20%).

The budget process subordination to the EC means that ESAs' staffing policies are subject to rules applicable to all EU Agencies, with salaries, level of seniority and other staff rules dictated by EU rubrics and the budget determined by EU Budgetary authorities (the Council and the European Parliament) to a great level of detail.

While tasks arising from new regulations should, in theory, accompany immediate additional budgeting, the EC budget rules allocate new staff only when new rules are published in the Official Journal and for the following budgetary year. This procedure results in a lack of flexibility that may impede an efficient and timely reaction to markets events.

Long recruitment procedures (more than 6 months on average) are also a potential obstacle to ESAs' efficiency. Additionally, the lack of fungibility of staff and other resources prevents the ESAs from using free budgetary resources from others projects to meet immediate needs.

4. Access to data. The Regulation establishing the ESAs contains provisions indicating that the ESAs should be able to access, via European and national counterparties, all the information necessary to conduct their activities. However, in practice, direct, easy access to institution-specific data has proven challenging. For instance, the EBA relies on the NCAs for data collection and the performance of first level data control. They are well placed to ensure the quality of the data transmitted. While this system may be seen as cost-effective because it avoids duplicating reporting line for banks, it may expose the EBA to timing concerns, as the correctness and data integrity need to be verified by the NCAs. Moreover, when data are incomplete or lacking, requiring a vote from the BoS to provide data for particular studies may hinder ESA's ability to be timely and effective in its work.

Appendix 3 – References to the Balance of Competences Questions

Question	Paragraph
1. How have EU rules on financial services affected you or your organisation? Are they proportionate in their focus and application? Do they respect the principle of subsidiarity? Do they go too far or not far enough?	16,23,24
2. How might the UK benefit from more or less EU action? Should more legislation be made at the national or EU level? Should there be more non-legislative action, for example, competition enquiries?	8,12,15,16
3. How have EU rules helped or made it harder to achieve objectives such as financial stability, growth, competitiveness and consumer protection?	2 – 4,8 *We also note the useful statistics which are quoted by the BBA in response to this question.*
4. Is the volume and detail of EU rule-making in financial services pitched at the right level? Has the use of Regulations or Directives and maximum or minimum harmonisation presented obstacles to national objectives in any cases?	6,10,20-24 *We also note and support the points raised by the BBA in response to this question.*
5. How has the EU's approach to Third Country access affected the ability of UK firms and markets to trade internationally?	3,4 *We also note and support the points raised by the BBA in response to this question.*
6. Do you think that more or less EU-level regulation in the area of retail financial services would bring benefits to consumers?	*Given our focus on wholesale markets, we have not provided comment in this area. However, we would note the interesting case study on the EU Data Protection Directive as discussed in the BBA's response.*
7. What has been the impact of the shift towards regulation and supervision at the EU level, for instance with the creation of the European Supervisory Authorities? Should the balance of supervisory powers and responsibilities be different?	8,16,18-23,27-28 *In addition, we would note the useful analysis provided in the ECON study (Oct 2013) which, amongst other things, concludes that:* *- the ESAs have been established successfully but need a stronger foundation, in particular enhanced governance for decisions on EU-wide supervisory consistency issue and* *- the benefits of the Single Rulebook will be lost without consistent implementation and application.*
8. Does the UK have an appropriate level of influence on EU legislation in financial services? How different would rules be if the UK was solely responsible for them?	
9. How effective and accountable is the EU policy-making process on financial services legislation, for example how effective are EU consultations and impact assessments? Are you satisfied that	24-25

democratic due process is properly respected?	
10. What has been the effect of restrictions placed on Member States' ability to influence capital flows into and out of their economy, for example to achieve national public policy or tax objectives?	4 *We would also refer to the useful statistics prepared by London Economics, and as quoted in the BBA's response.*
11. What may be the impact of future challenges and opportunities for the UK, for example related to non-membership of the euro area or development of the banking union?	*We support the BBA's comment insofar as it relates to the FTT.*
12. Do you have any further comments about issues in addition to those mentioned above?	5