

## Consultation response

### **Response to the EU Commission consultation on the review of the European System of Financial Supervision (ESFS)**

31<sup>st</sup> July 2013

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The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the review of the European System of Financial Supervision. 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. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association ("GFMA"), a global alliance with the Securities Industry and Financial Markets Association ("SIFMA") in the US, and the Asia Securities Industry and Financial Markets Association ("ASIFMA") in Asia.

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

Due to the complex and extensive issues raised by this consultation, the response is organised not on a question-by-question basis but according to a small number of key themes. For ease of reference however, footnotes and Appendix 3 identify the correlation between the different paragraphs of the response and the consultation questions.

This response has been developed with the assistance of Promontory Financial Group.

## List of Abbreviations

<b>AFME</b>	Association for Financial Markets in Europe
<b>AIFMD</b>	Alternative Investment Fund Managers Directive
<b>ASC</b>	Advisory Scientific Committee
<b>ASIFMA</b>	Asia Securities Industry and Financial Markets Association
<b>BoS</b>	Board of Supervisors
<b>CCP</b>	Central Counterparty Clearing House
<b>CEBS</b>	Committee for European Banking Supervisors
<b>CRA</b>	Credit Rating Agency
<b>CRD</b>	Capital Requirements Directive
<b>CRR</b>	Capital Requirement Regulation
<b>CSDR</b>	Central Securities Depository Regulation
<b>EBA</b>	European Banking Authority
<b>EC</b>	European Commission
<b>ECB</b>	European Central Bank
<b>EMIR</b>	European Markets Infrastructure Regulation
<b>EIOPA</b>	European Insurance and Occupational Pension Authority
<b>ESA</b>	European Supervisory Authority
<b>ESFS</b>	European System of Financial Supervision
<b>ESMA</b>	European Securities and Market Authority
<b>ESRB</b>	European Systemic Risk Board
<b>EU</b>	European Union
<b>GFMA</b>	Global Financial Markets Association
<b>IT</b>	Information Technology
<b>MEP</b>	Member of the European Parliament
<b>MIFID</b>	Markets in Financial Instruments Directive
<b>NCA</b>	National Competent Authority
<b>SSM</b>	Single Supervisory Mechanism
<b>SSR</b>	Short Selling Regulation
<b>TR</b>	Trade Repository

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## Executive summary

The Review of the European System of Financial Supervision (“ESFS”) is being conducted only two years after the system’s inception and the establishment of the constituent entities. 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”). However, 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 possible improvements could be made.’

AFME believes that radical reforms requiring fundamental institutional changes are not necessary at this stage. However, important modifications are desirable and necessary in order to achieve the objectives of the system and to improve the manner in which it supports<sup>2</sup> integration of European financial markets and the functioning of the European economy.

In particular, we present four significant areas that 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.

Below, we detail each area.

### 1. Consolidating and enhancing the capacity of the ESAs

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 should be improved and 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. The consultation period has been too short to allow us to do this. 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. Among the options considered, 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, 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.

## 2. Rebalancing the ESAs' work

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.

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 intensively 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 new 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.

**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.

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

## 3. Improving the rule-making process

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

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. An exercise in quality control would significantly enhance the overall process. We suggest that the ESAs produce an initial timeline for the implementation of the Level 1 rules and conduct periodic reporting on how the rule-making process is being implemented between Level 1 and Level 2;
- c. 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' opinion of the time necessary for the delivery of their technical standards and for their effective implementation by market participants;
  - 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;
- d. We emphasise the importance of:
  - i. Impact assessment including cost benefit analysis where appropriate, fundamental parts of rule-making; and
  - ii. A robust dialogue with relevant stakeholders.

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 to more systematically involve technical consultative groups, composed by

experts in the relevant areas of activity, drawing from the positive experience of the groups established by ESMA. While interactions between Stakeholder Group and ESAs are important, these should neither be taken as a substitute for public consultation, nor as exhausting the technical dialogue with market participants

- e. 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.

#### **4. Enhancing the macroprudential supervision framework**

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.

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 that 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.

### **Concluding remarks**

AFME considers this initial assessment to be instrumental in the identification of the functional areas of the ESFS where improvements should be sought and that further analysis would be necessary to further develop some of the proposals made. AFME and its members stand ready to contribute further to this review.

## Introduction

1. AFME welcomes the opportunity to comment on the consultation launched by the EC on the review of the ESFS. This response has been developed with the assistance of Promontory Financial Group.
2. The creation and establishment of the ESFS in 2011 was an unprecedented step in modifying the regulation and supervision of the EU financial sector and fostering the completion of the Single Market in financial services. The reorganisation of the European financial architecture was in large part a response to the weaknesses in the EU financial supervisory framework and a reaction to the financial crisis.
3. The implementation of the reform gave rise to the establishment of three new ESAs – EBA, ESMA and the European Insurance and Occupational Pension Authority (“EIOPA”) – transformed from the pre-existing “Level 3 Committees” of EU supervisors, the formation of a new body (the ESRB) responsible for macroprudential supervision and the identification and mitigation of potential systemic risks, together with the revision of the rule-making procedures for the technical implementation of so called “Level 1” provisions.
4. The ESAs received a wide range of new responsibilities – some regulatory, others supervisory in nature – with ESMA also being empowered with the direct and exclusive supervisory responsibility for Credit Rating Agencies (“CRAs”) established in the EU and, more recently, for Trade Repositories (“TR”). In preparing this response, AFME conducted an analysis of the major areas of activity of the ESAs and the ESRB, differentiating between rulemaking and supervisory activities, and focusing on examples of good and bad practices, to identify core work methods that should underpin both activities.
5. Although two years of existence constitute a rather limited period for making a full assessment of the functioning of the framework and the ESAs, this period has been sufficiently intense in activity and informative in nature to enable a preliminary assessment and identify possible areas for improvement.
6. Beyond the initial commonality of powers assigned to each Authority, the ESAs are materially distinguished from each other as a result of differences in the various legislative interventions, starting with the Omnibus Directives to the sectoral legislations and most recently including the reform of the EBA decision-making process following the centralisation of banking supervision in the Euro Area. The departure from a single

platform has confirmed the need for a differentiated approach between the banking, securities and insurance sectors.

7. This response is based on our members' direct experience with the ESAs (more pronounced with ESMA and EBA, than with EIOPA) and the ESRB since their establishment and suggests certain principles that should guide the forthcoming review of the ESFS. Rather than focusing on each individual question of the questionnaire, this response focuses on the key messages AFME would like to present through this consultation. As a result, not every subject is addressed with the same concern or level of detail. Footnotes and Appendix 3 identify the correlation between the different paragraphs of the response and the consultation questions.
8. Looking ahead, AFME recommends that the European Commission (the "Commission" or "EC") conduct a thorough assessment of individual needs given that each ESA is different - this should ensure that each Authority is granted sufficient powers and resources to effectively discharge the unique tasks allocated to them by existing and forthcoming sectoral legislation. The Commission should seek ESAs' input on their effective needs.
9. AFME recognises that finding solutions to the problems identified can be challenging. In most cases, additional time would be required to develop well-articulated proposals. Where possible, *AFME makes proposals and presents ideas to be developed and explored further*. AFME thanks the Commission for establishing a dialogue with market participants on what is an important review for the EU financial sector; we are available to further assist the European Commission in this open dialogue.

## **I. Enhancing the ESAs' capacity**

10. AFME believes that the establishment of the ESFS represents a major step forward towards the completion of the Single Market of financial services. The crisis and the regulatory responses within the EU, as well as in other countries outside of the EU, have only strengthened the need for a cohesive framework whereby the rules are developed, interpreted and implemented in a convergent manner<sup>1</sup>.
11. AFME believes that fundamental structural reforms to the ESFS, modification to its overall architecture (for instance, by reducing the number of bodies), and any expansion in the scope of its mandate<sup>2</sup> are unnecessary at this stage. Moreover, existing human and financial resources remain limited, so diverting the ESAs from their current mandated activities and extending the scope of their responsibilities (e.g. increased supervisory mandate and direct product intervention) would likely increase the risk of regulatory failure. Hence, AFME urges the ESAs to focus on the delivery of their current

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<sup>1</sup> Question 1.1.a

<sup>2</sup> Against this background, AFME suggests addressing the impact of the establishment of the SSM on the functioning of the ESFS. Among the ESAs, these implications will be more significant for EBA than for the other two (ESMA and EIOPA).

important responsibilities and regulatory agendas and suggests granting the ESAs the necessary resources to effectively discharge these functions<sup>3</sup>.

12. The objectives set for the three ESAs and for the ESRB remain valid. The capacity of the ESAs, within and outside of the EU, should be enhanced by granting them all resources necessary for the fulfilment of their tasks<sup>4</sup>.

Whilst important progress has been made since the ESAs' establishment, particularly in the regulatory field, much remains to be done. For instance, the Single Rule Book, supervisory convergence and leadership discussions with non-EU regulators, are just a few examples of the areas in which important improvements can be achieved. AFME considers the following conditions necessary to further develop the leadership capacity of the ESAs:

- a. Further strengthening their independence;
- b. Enhancing their leadership capacity in international discussions; and
- c. Granting them the necessary resources<sup>5</sup>.

#### *Strengthening the independence of the ESAs*

13. The governance structure of each ESA, while still constrained, is better than that of the previous three "Level 3" Committees. However, in its current governance and decision-making process setting<sup>6</sup>, each ESA operates under unaccommodating constraints, potentially impacting their effectiveness. These weaknesses include the limited powers of the Chairperson, the limited role of the Management Board, the lack of full independence to adopt technical standards vis-à-vis the EC and the strong influence exercised by the national authorities in the decision-making process<sup>7</sup>.
14. New measures related to the ESAs' governance structures could be adopted to improve the effectiveness of the ESAs. Efficient governance requires a clear allocation of responsibilities and decision-making powers, as well as the ability to perform duties independently<sup>8</sup>.
15. AFME believes that the capacity of the ESAs could be enhanced by strengthening their independence from national authorities. Although Article 42 of the regulation establishing the ESAs requires that voting members of the BoS, "act independently and objectively in the sole interest of the Union", national interests and coalitions of interest

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<sup>3</sup> Question 1.1.b

<sup>4</sup> Question 1.1.b

<sup>5</sup> Question 1.1.b

<sup>6</sup> Appendix 2 provides a brief description of the current governance structure of the ESAs.

<sup>7</sup> Question 1.2.1.a

<sup>8</sup> Question 1.2.1.a

invariably influence outcomes. Similarly, a voting member cannot normally make a decision on a case in which he has a personal conflict of interest, but nothing prevents him from voting on an issue regarding his own national authority<sup>9</sup>.

16. AFME would encourage the exploration of possible reforms to achieve greater independence of the ESAs. In particular, AFME envisages the following options:

- a. Granting voting rights to the Chair for decisions adopted by the BoS<sup>10</sup> for those cases that involve decisions based on “one person, one vote”;
- b. Considering possible governance reforms that could distinguish regulatory and other tasks (such as direct supervision and convergence in supervisory practices), as well as assessing the current role and composition of the Management Board and exploring proposals to expand its role and powers. The consultation period has been too short to allow us to achieve this. Amongst 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. Consideration should be given to entrusting the reformed Executive Board with specific new competences and powers, such as<sup>11</sup>:
  - i. Making decisions on directly supervised entities (if any);
  - ii. Adopting decisions on supervisory convergence, peer-reviews, mediation, breaches of EU law, and actions in emergency situations<sup>12</sup>;
  - iii. Making decisions to be adopted under very tight deadlines (for instance the decisions to be adopted by ESMA under the Regulation on Short Selling); and
  - iv. Preparing the meetings of the BoS.

Note that the Executive Board and its members would need to commit to independence and the pursuit of European interests only;

- c. Reforming the composition of the BoS by making the members of the Executive Board full members of the BoS and granting them voting rights for those cases that involve decisions based on “one person, one vote”<sup>13</sup>.

### *Enhancing the ability of the ESAs to engage in dialogue with third-country regulators*

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<sup>9</sup> Question 1.2.2.a

<sup>10</sup> Question 1.2.2.c. The decision making rules would be adapted when qualified majority applies.

<sup>11</sup> Question 1.2.2.b

<sup>12</sup> The BoS may object to these decisions after a vote adopted at by a qualified majority.

<sup>13</sup> Question 1.2.2.c. The decision making rules would be adapted when qualified majority applies.

17. 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, international negotiations, and cross-border convergence. To date, the ESAs appear to have played a limited role in international *fora*, such as with standards setters and other international bodies and in bilateral contacts with non-EU regulators<sup>14</sup>.
18. Furthermore, a number of equivalence assessments have been delayed or are behind schedule in key dossiers. Where legislation contains an obligation for the EC or the ESAs to conduct equivalence assessments (e.g., European Markets Infrastructure Regulation ("EMIR"), Alternative Investment Fund Managers Directive ("AIFMD"), SSR, Markets in Financial Instruments Directive ("MIFID")), those assessments must be conducted in a timely fashion so that foreign market participants can fulfil their regulatory obligations and pursue their activities in the region, especially given the pre-eminence of Europe as a global market<sup>15</sup> and the needs of economic actors to have access to international financial services.
19. A proposal to improve the development of the role of the authorities could be to entrust the ESAs with adequate powers to ensure their capacity to interact at arm's length with third-country regulators such as providing them with a leading role in the EU-US Financial Market Regulatory Dialogue and enhancing their visibility and "voice" in international bodies.

*Helping ESAs achieve their statutory objectives and adequately discharge their tasks by investing in them the necessary resources*

20. Since their establishment, the ESAs have been progressively given more responsibility without a parallel increase in their overall allotment of resources. AFME believes there should be consistency between the scope of tasks and activities assigned, the level of financial resources granted, and the quantity and quality of staffing. Compromising one of these components would increase the probability that goals remain unfulfilled<sup>16</sup>.
21. Limited resources are a major impediment to the current and future effectiveness of the ESAs. Whilst it is difficult to objectively assess the needed level of staff, it is the ESAs responsibility to detail the resources necessary for the fulfilment of tasks and duties. An increase in the allotment of financial resources is justified, particularly at the initial phase, not only to equip the ESAs with adequate staffing levels, but also to invest in the

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<sup>14</sup> Question 5.a

<sup>15</sup> Question 5.a

<sup>16</sup> Question 1.1.c

necessary projects, such as information technology (“IT”) systems and infrastructure, to enhance performance of data sharing and streamline processes<sup>17</sup>.

22. Regarding staffing, AFME believes that considerably more resources should be provided, especially considering the more intensive resource needs of staff devoted to supervisory convergence, peer reviews, mediation, attendance of colleges of regulators, breaches of EU law, etc, as opposed to those devoted to regulatory activities. Special attention should be given to the profiles of future recruits, with a particular focus on their seniority and expertise in the technical areas to be regulated and/or supervised: the ESAs could make publicly known specific areas where product expertise is needed – e.g. fixed income, equities, derivatives, FX, commodities, post-trade/operations, and investment. Regarding projects, particularly those related to IT, AFME believes that material investments should be made to ensure the enhancement of IT systems in the next two to four years<sup>18</sup>.
23. AFME believes that the current budgeting model of the ESAs, subject to proposal from the EC and decision by the Budgetary Authority, may undermine the ESAs’ independence and put at risk resource allocation levels. This is particularly visible with staffing, where required budgeting is not always conducted in a timely manner that facilitates recruitment procedures and ensures the flexibility necessary to handle new challenges and tasks. The EBA’s work program for the build-up of a Single Rule Book is particularly vulnerable, as this work program is demanding and calls for an increase in staffing and resources<sup>19</sup>.
24. Furthermore, some national authorities already face a lack of available resources, while coping with a considerable increase in their contributions to the ESAs’ funding, which give rise to potential conflicts of interest.
25. AFME encourages a greater level of financial independence from the European Commission and from national authorities. Among the options considered, the EU might make a greater contribution to ESAs from its own budget rather than requiring funding from national authorities, together with the creation of a specific budget line in the community budget<sup>20</sup>.

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<sup>17</sup> Question 1.1.c

<sup>18</sup> Question 4.e

<sup>19</sup> Question 1.2.3.a

<sup>20</sup> Question 1.2.3.a

## II. Rebalancing the ESAs' work

26. In their first years of activity, the ESAs have been more active in rulemaking than in supervisory convergence. Some powers, such as mediation, breaches of EU law and even conducting peer reviews seem to have received less attention than other tasks, such as the production of regulatory standards. It is not clear whether this situation reflects prioritisation of actions by the ESAs, lack of available resources or other considerations of a policy nature. AFME recommends that a similar level of attention and intensity be devoted to all ESA tasks. The important production of new rules requires an even greater focus on the convergence of supervisory practices to ensure their consistent implementation<sup>21</sup>.
27. However, establishing an effective regulatory convergence should not result in an excessively rigid approach to supervision. This requires combining convergence and flexibility in supervisory judgment, while also undertaking an analysis of the desirable degree of convergence between different areas and recognising that the optimal degree of convergence may vary with a number of legitimate factors (e.g., it might be more intense where there is a genuine cross-border market, as in the case of wholesale and capital markets activities, as opposed to more domestic markets, such as retail mortgages)<sup>22</sup>.
28. 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 make use of available instruments to strengthen convergence in supervisory practices. This should include the development of a comprehensive and coherent body 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 promotes a consistent supervisory culture. The Single Supervisory Handbook to be developed by the EBA under the new 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 significant resourcing.
29. The ESAs should make systematic use of powers to enhance a common supervisory culture, including providing training, harmonized reporting, data sharing and supervisory disclosure.
30. The ESAs should be conducting more peer reviews exclusively with the ESAs' staff. Consideration should be given to entrusting the newly-established Executive Board as proposed above with their approval. There should be further discussion as to the merit of the publication of the results of peer reviews - in particular, whether, in order to

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<sup>21</sup> Question 1.1.2.a

<sup>22</sup> Question 1.1.2.a

enhance their effectiveness, it is preferable to always request the publication or rather allow certain degree of flexibility.

31. There should be proactive use of mediation and other powers to enhance a common supervisory culture, such as participation in supervisory colleges, providing training, adopting harmonized reporting, data sharing and supervisory disclosure<sup>23</sup>.
32. The focus on the convergence of supervisory practices and culture should be safeguarded in the establishment of the ESAs' work programs. Whilst preserving their independence, the ESAs should be subject to closer monitoring during the preparation of their annual and multi-annual work programs and subsequent implementation, so as to ensure that all available powers are activated<sup>24</sup>.

### **III. Improving the rule-making process**

#### *Applying principles for good regulation*

33. One of the key objectives of the reform establishing the ESFS was the progressive achievement of a Single Rulebook across the EU. To pursue this objective, in AFME's opinion, the process underpinning the development of financial regulation should be based on the following principles:
  - a. *Clarity and certainty*: Ensure clarity and appropriate certainty of mandate when setting goals for regulatory policy across the EU. Clarity also refers to the regulatory philosophy, with a particular emphasis on a focused outcome and ultimate results. Clarity must also be ensured so that the division of responsibilities between the political and technical level is known and that rule-making procedures comply with this division and result in clear outcomes;
  - b. *Efficiency*: Efficiency should result from ensuring that the mechanism for the adoption and implementation of norms, ranging from legislation to the definition of technical standards, is consistent and avoids duplication (e.g., not using the implementation phase for reopening discussions on policy objectives). Further clarity regarding priorities in the development of rule implementations is also needed and is attainable by distinguishing what is necessary at first implementation ("shall" provision) and what should be developed later on ("may" provisions);

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<sup>23</sup> Question 1.1.2.a

<sup>24</sup> Question 1.1.2.a

- c. *Openness and transparency*: Openness requires, above all, a sound and extensive consultation of the industry and a real dialogue with regulated entities and all other interested parties and stakeholders; and
- d. *Evaluation*: Evaluation should be conducted both *ex-ante* and *ex-post*. At the *ex-ante* level, such assessment is essential to measure the economic impact of previously envisioned rules, on both a macro and micro level, and their combined effects with other rules that are already in place or currently in the process of being adopted. At the *ex-post* level, the assessment should take the form of a quality check on the process followed, including its timeline, and on the standards necessary for ensuring the end result is consistent with the objectives and expectations.

Based on the experience of the last two years, improvements related to all of these principles are achievable and expected.

34. The intensity of the legislative and regulatory agenda over the last two years provides fertile ground for evaluating the decision-making process against these aforementioned principles. Appendix 1 provides a synthetic overview of what AFME considers to be examples of good and bad practices, supported by the concrete experience of its members.

*Addressing the lack of certainty and consistency in the rule-making process between Level 1 and Level 2*

35. AFME would like to highlight that a lack of clarity and appropriate levels of certainty in stated objectives of legislative text can hamper a smooth decision-making process in the technical implementation phase. In particular, certain matters that have been debated and to which agreement has been reached at Level 1, may be revisited later during the Level 2 and Level 3 phases<sup>25</sup>. This may undermine the functioning, and also the potential, of the legislative and rule-making processes. They also have the potential to deplete industry and regulatory resources<sup>26</sup>. We believe that in a number of cases the Level 1-Level 2 relationship has not functioned as it should and that this aspect needs to be addressed. See Appendix 1 for discussion of a number of examples.
36. AFME encourages greater clarity and certainty in Level 1 texts and in mandates for the subsequent development of Level 2 rules. Increased clarity would streamline the decision-making process for the implementation of technical measures and minimize the likelihood of matters being reopened during a different phase. One possible way to achieve this would be for the Commission and the Co-legislators to adopt an Inter-

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<sup>25</sup> See Appendix 1

<sup>26</sup> Question 1.1.1.a

Institutional Agreement setting out the agreed principles that any provision mandating the adoption of technical implementation standards and the mandates given to the ESAs to prepare the draft standards should respect<sup>27</sup>.

37. Another key element for improving the quality of regulation is to ensure “routine disciplines” to safeguard the technical quality of legislative and technical proposals. On this front, AFME suggests that the ESAs produce an initial timeline for the implementation of the Level 1 rules and conduct periodic reporting on how the rule-making process is implemented between Levels 1 and Level 2. Finally, an exercise in quality control (i.e., ensuring that adopted regulations are in line with expectations and initial objectives respect the initial timeline), would significantly enhance the overall process. The possibility of establishing a Committee to monitor adherence to these principles should also be explored<sup>28</sup>.

*Avoiding excessively prescriptive rules*

38. AFME also recalls that good regulation requires rules to be risk-sensitive, outcome-focused and only developed after impact analysis. 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. This also reflects the need for adaptation to changing environments.

39. Firms should be afforded sufficient leeway (both in terms of flexibility and timing) to adapt their systems to better achieve regulatory objectives and to avoid adapting an identical approach for the entire industry (a “one size fits all” approach).

*Safeguarding minimum timelines for rules implementation*

40. ESAs are frequently confronted with very strict deadlines to draft technical standards dealing with complex subject matters. This may be to the detriment of the quality of their proposals and have potentially negative impacts on the market. Furthermore, such time constraints have a direct impact on the implementation programs of many firms and increase the risk that implementation deadlines will not be met<sup>29</sup>.

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<sup>27</sup> Question 1.1.1.a

<sup>28</sup> Question 1.1.1.a

<sup>29</sup> Question 1.1.1.a

41. The timing of consultations carried out by the ESAs could also be improved. AFME notes that consultations are often conducted over a short period of time, negatively affecting the overall quality of answers provided. Thus, one proposal is to incorporate formal time periods for consultation, rather than simply set deadlines.
42. We encourage the exploration of techniques to ensure that appropriate time is available for rule-writing and testing, the development of new rules or for the introduction of a new supervisory framework, such as:
- a. Allowing participation of ESAs' representatives as observers in technical discussions during the negotiations of the adoption of new legislative measures (such as Working Groups of the Council), so as to facilitate a strong understanding of the problems the ESAs will be asked to address;
  - b. Asking the ESAs' opinion of the time required for the delivery of their technical standards before the finalisation of mandates in new legislative acts and for their effective implementation by market participants;
  - c. Involving the ESAs in the preparation of the Commission's mandates; and
  - d. Allowing the ESAs, when they have found deadlines to be too tight to be met, to ask for a form of suspension and pause in the process to focus on quality, rather than timeliness.

*Strengthening impact analysis*

43. AFME emphasises the importance of cost-benefit analysis and impact assessment, a fundamental part of rule-making. Impact analysis could be improved by conducting cumulative impact assessment in cases where rules have cumulative effect. In cases in which there has been a material increase in the burden on market participants from the regulatory requirements stipulated at Level 1 the need for impact assessment is always present. For instance, the SSR market making guidelines provided significant additional detail as to when and how the market making exemption applied, such that there would be an increased compliance burden on firms in order to comply, with consequent cost implications for clients. However, no impact analysis was conducted in relation to these proposals (the consultation paper simply cross-referenced the Level 1 impact analysis)<sup>30</sup>.

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<sup>30</sup> Question 5.a

44. AFME believes that good quality impact assessment benefits all parties involved. For this reason, we believe it is unrealistic to rely on market participants to conduct market-wide impact assessments during an open consultation to identify the unintended and detrimental market impacts from possible requirements. The onus should be on regulators, as they have access to market-wide information (e.g. transaction reports, order book data, mandatory requests to regulated firms, etc.)<sup>31</sup>.
45. Often, complex market impacts need to be further measured following the implementation of a requirement and after analysing order/trade behaviour in response to that requirement (e.g. SSR market making guidance)<sup>32</sup>.
46. The onus to provide concrete evidence of significant detriment via responses to a consultation exercise cannot be placed on market participants. In such cases, the better approach will be for ESAs to conduct earlier and more significant research into the likely impacts or commission independent market studies (accepting that only possible/likely effects can be given). Note that this should be sufficient to decide whether caution is required. However, market participants and ESAs' Stakeholder Groups should always be available to provide technical markets expertise to ESAs.
47. AFME also believes that impact assessments should consistently consider alignment with internationally agreed standards and the approach taken in other key jurisdictions outside the EU. This is justified by the aim of limiting global regulatory divergence which could be detrimental to global trade and, therefore, the EU economy. The ESAs should limit applying additional requirements over and above those international agreed standards unless genuinely appropriate in light of specific features of the EU context.

*Strengthening the dialogue with relevant stakeholders*

48. Generally speaking, consultation with the industry has in many respects been satisfactory in the recent period. Engaging with market practitioners and firms subject to regulation contributes to the implementation of high quality regulation and facilitates the future implementation of the rules. AFME encourages further development and enhancement of the consultation mechanism with market participants.
49. One way of enhancing the dialogue with stakeholders is to deepen the role played by Stakeholder Groups to collect views representing a wide range of diversified interests.

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<sup>31</sup> Question 5.a

<sup>32</sup> Question 5.a

50. However, it is AFME's opinion that the composition of Stakeholder Groups does not always sufficiently ensure a balanced representation of stakeholders in relevant sectors, thereby limiting the effective consultative function of participants. For example, in the composition of the ESMA Stakeholder Group, certain interests may be considered overrepresented and unduly limited attention is placed on the representation of financial intermediaries given their role in well functioning capital markets supporting the European economy<sup>33</sup>.
51. The composition of the Stakeholder Groups seems to particularly focus on country representation rather than ensuring wide, cross-industry participation. A reflection on the composition of the Stakeholder Groups should therefore be considered. More broadly, it is essential for the credibility of the ESAs that the selection criteria and process should be more transparent, meaning information on the process should be shared publicly<sup>34</sup>.
52. AFME would appreciate early engagements with Stakeholder Groups and market participants to be conducted both before the publication of a consultation exercise and after the closure of a consultation. This would complement the greater transparency of the selection criteria and process for Stakeholder Group's appointments, as well place a greater focus on the composition of Stakeholder Groups, so as to reflect industry-wide views rather than country representation. It is notable that not all of the Stakeholder Groups contain extensive capital markets expertise; this should be addressed in future revisions of all of the Stakeholder Groups' composition<sup>35</sup>.
53. AFME also suggests increased publicity of the Stakeholder Groups in order to fully assess relevance and the true contribution made<sup>36</sup>.
54. However, while AFME supports interactions between Stakeholder Group and ESAs, we would like to highlight that comments made by these groups should neither be taken as a substitute to public consultations, nor as exhausting the technical dialogue with market participants. AFME suggests that the ESAs intensify the dialogue with market professionals to gain access to key insight and technical expertise. One possible solution would be for the ESAs to follow the example of ESMA for establishing technical consultative groups, composed by experts in the relevant areas of activity. Another solution for improving the dialogue with market participants is to organise 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.

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<sup>33</sup> Question 1.2.4.c

<sup>34</sup> Question 1.2.4.d

<sup>35</sup> Question 1.2.4.b

<sup>36</sup> Questions 1.2.4.a and 1.2.4.e

#### **IV. Enhancing the macroprudential supervision framework**

55. Following the de Larosière report, we envisage a macroprudential supervision framework based on the following four principles:

- a. The scope of macroprudential supervision should cover all areas of finance and should not be confined to the banking industry and subject to general economic conditions;
- b. It should be based on the prioritisation of risks and risk warning issues;
- c. Given its unique position within the Euro system, the ECB should provide support; and
- d. The ESRB should constitute a pillar in macroprudential supervision, while the ESAs should constitute a key part of microprudential supervision.

56. The two supervision pillars, micro and macro, should be mutually reinforcing and benefit from cross-involvement. Macroprudential supervision can be efficient only if it is capable of impacting microprudential supervision. Similarly, microprudential supervision cannot ensure financial stability unless it is guided by considerations at the macroprudential level.

57. Whether the ESRB has correctly fulfilled its mandate is difficult to assess, since macroprudential supervision is a relatively new topic, is still debated between experts, and comprehensive criteria or benchmarks have not yet been developed for measuring performance.

58. There is a need for further debate, beyond the limited timeframe provided by this consultation, on achieving optimal macroprudential supervision in Europe.

59. Despite this difficulty, AFME would encourage a review of the following elements:

*A lack of transparency and communication to the industry regarding macroprudential issues*

60. The macroprudential supervision framework is victim to a surprising paradox: despite a wide array of membership, with nearly 70 authorities represented, dialogue with stakeholders remains in need of development. The annual report published on 8 July 2013 gives little attention to the development of external dialogue or to consultation

with various stakeholders. The only internal organ dedicated to the consultation is the Advisory Scientific Committee (“ASC”), which is composed of 15 independent experts.

61. In the future, AFME would encourage an increased focus on “external” dialogue with financial firms to better identify potential sources of systemic risks, as well as other areas of activity related to the ESRB and also greater use of industry practitioners in balance with academics and other experts<sup>37</sup>.

*Simplifying the governance structure of the ESRB*

62. In its current setting, the ESRB is performing its mandate under a set of institutional constraints inherent in the EU regulation, thereby hindering its capacity to make decisions in a timely manner. The ESRB has a complex organisational structure – with its General Board composed of a large number of members – resulting from the need to ensure high-level policy representation of its 27 member states. The ESRB has no legal personality and is dependent on the ECB, which provides administrative, logistical, statistical and analytical support<sup>38</sup>.
63. AFME would suggest strengthening and simplifying the governance of the ESRB. Our members are still considering whether, among the possible options that could be considered, is the introduction of a full-time Chair or Managing Director to speak on behalf of the ESRB and support the ESRB in its day-to-day activities, as well as enhancing the role of the Steering Committee, as opposed to the General Board<sup>39</sup>. Once again, given the time constraints, there has not been the option to discuss these possible options in detail with AFME members. Accordingly, our recommendation is for further consideration to be given.
64. Regarding the achievement of activities undertaken by the ESRB to date, AFME would highlight that despite some obvious progress made towards the development of the macroprudential supervision framework, both at the national and European level, the ESRB still suffers from a lack of visibility<sup>40</sup>.
65. We expect that the creation of the SSM will have important consequences for the macroprudential supervision framework for banking in the euro area. This will indirectly impact the operations of the ESRB. One of the immediate consequences might be that the ESRB must frame its activity in a complex system composed of three different layers: the European Union, the euro area and the individual member states,

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<sup>37</sup> Question 2.4.2.a

<sup>38</sup> Question 2.1.1.a

<sup>39</sup> Question 2.2.1.1.a

<sup>40</sup> Questions 2.2.1.1.b and 2.4.1.a

risking the fragmentation of the macroprudential supervision framework<sup>41</sup>. In the first instance, there is a need to clarify the role of the ESRB vis-à-vis the ECB in the context of the establishment of the Single Supervisory Mechanism.<sup>42</sup>

## **APPENDICES**

### **APPENDIX 1 – Examples of “Sound and Poor Practices” in the Rulemaking Process**

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 there were noticeable flaws.

*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.

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.

Central Securities Depository Regulation (“CSDR”): Although Level 1 deliberations on CSDR have not yet been finalized, members of the industry were invited by ESMA to outline and explain their position on key items of this regulation at an early stage, as ESMA is preparing its work at Level 2. This is a helpful approach contributing both to timeliness and to achieving appropriate levels of technical input.

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<sup>41</sup> Question 4.d

<sup>42</sup> Question 2.2.1.1.b. For further discussion of macroprudential supervision and the SSM, see the recently published AFME report, Supervising cross-border banks in Europe: An industry survey in advance of implementation of the Single Supervisory mechanism. <http://www.afme.eu/Banking-Union/>

MiFID/R: AFME considers that ESMA and its staff are 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 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 hundreds of thousands of securities).

Securitisation CRA Issues: ESMA has recently conducted a constructive session where it solicited industry views on the implications of Article 8(b) Regulation 1060/2009 concerning securitisation issuer reporting requirements, which will have a material impact on issuance costs for this important real economy sector.

*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:*

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). AFME believes that 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 unduly tight 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.

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.

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”) has been suboptimal. The industry faces a relatively short time period in which to convince third country CCPs to apply for authorisation. Otherwise, members will have to cope with 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.

Securitisation risk retention (EBA): The industry noticed a lack of consistency in this particular area, in which the primary text on risk retention has not changed significantly (between the Second Capital Requirements Directive (“CRD2”) and CRR4). However, the primary text in CRD2 only makes sense in light of the guidelines issued by Committee for European Banking Supervisors (“CEBS”) and the EBA. Because the industry was not aware that the guidelines would be removed and because the primary text remained largely unchanged, there were 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.

Securitisations (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 securitization 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 BoS, composed of the heads of the 27 National Competent Authority (“NCAs”) in each Member State<sup>43</sup>, 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).

Figure 1: ESAs BoS meetings in 2012

	EBA	ESMA	EIOPA
<b>Number of BoS Meetings</b>	6	7	6

Source: ESAs annual report 2012

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

<sup>43</sup> In addition, there are observers from the European Commission (EC), ESRB, EBA and EIOPA.

- 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 are 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. For instance, the new recovery plan task will require 16 new EBA employees. However current EBA staff must await the final publication of the directive to onboard new hires, thereby limiting the EBA's ability to be ready with consultation and validation of Technical Standards on time.

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.

Figure 2: ESAs resources in 2012

	EBA	ESMA	EIOPA
<b>Budget (2012, in € million)</b>	19	20	16

<b>Staff (2012)</b>	95	85	87
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Source: ESAs annual reports 2012

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 EU Commission questionnaire

Corresponding table	
Questions	Paragraph number
1.1.a	10
1.1.b	11, 12
1.1.c	20, 21
1.1.1.a	35, 40
1.1.2.a	26, 27, 31, 32
1.2.1.a	13, 14
1.2.2.a	15
1.2.2.b	16-b
1.2.2.c	16-a, 16-c
1.2.3.a	23, 25
1.2.4.a	53
1.2.4.b	52
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4.e	22
5.a	17, 18, 43, 44, 45

#### Appendix 4 – Executive summary references to the response

Corresponding table	
Executive Summary paragraph number	Response paragraph number
1.a	13, 14, 15, 16
1.b	17, 18, 19
1.c	20, 21, 22, 23, 24, 25
2	26, 27, 28, 30, 31, 32
3.a	34, 35, 36
3.b	35, 36, 37
3.c	40, 41, 42
3.d	43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54
3.e	38, 39
4.a	60, 61
4.b	62, 63, 64
4.c	65