21 May 2021
ESMA22-106-3378

SMSG response to the "Targeted consultation on the supervisory convergence and the single rulebook" launched by the European Commission on 12 March 2021

Executive summary

The SMSG welcomes the opportunity to respond to the European Commission's targeted consultation on supervisory convergence and the single rulebook. The consultation seeks targeted views on certain aspects related to the 2019 ESAs review and to the development of the single rulebook.

The SMSG believes that the recent changes to the ESAs Regulations brought rather positive results in different areas of ESMA remit. Examples of positive effects relate to the reinforced supervisory convergence in terms of peer reviews, the increased scope of direct supervision of specific entities, the responsibilities of ESMA in sustainability and digital transformation, and the Union Strategic Supervisory Priorities for NCAs coordinated by ESMA.

The SMSG notes that a comprehensive assessment of the effectiveness of the changes to the ESAs Regulations would be more meaningful when additional time will have elapsed since the changes entered into force. However, the SMSG is also of the opinion that some remarks can already be proposed at this time with respect to selected topics.

This document provides the SMSG's view on the following aspects: the Q&A process, the 'No-Action'-letters, the composition of the stakeholder groups, the future scope of direct supervisory powers of ESMA, the audit legislation, the EU legislative process, the ESAs' mandate and the structure of the European supervisory architecture.

As for the Q&A process, unless specific reasons require prompt intervention, the SMSG believes that public consultation would be useful in the process of drafting Q&As and suggests that relevant stakeholders groups and consultative working groups should be consulted on a systematic basis.

As for the 'No-Action'-letters, the SMSG regrets that, in contrast to the Parliament's proposal and to the tools available to the authorities in other jurisdictions, the 'No-Action'-letters mechanism introduced by the 2019 review does not give the ESAs the power to reform or suspend EU legislation unilaterally.

As for the composition of the stakeholders groups, the SMSG highlights the positive contribution of academics in the functioning of the groups and suggests to reconsider the number of academics.

As for the ESAs' direct supervisory powers, the SMSG believes that, at this stage, the current situation is satisfactory as regards the supervision of market participants and financial institutions by NCAs. However, in a forward-looking perspective, the SMSG also believes that it would be worth exploring a potential expansion of ESMA´s direct powers with respect to some entities and some areas.

As for the audit legislation, the SMSG – with reference to its own initiative report on the Wirecard case issued in February 2021 (ESMA22-106-3194) – highlights the need to consider a comprehensive reform of the EU audit rules.

As for the EU legislative process, the SMSG notes that EU co-legislators should ensure that all crucial political issues are dealt with at level 1. The SMSG also believes that reducing undue divergences within and across levels would certainly enhance the single rulebook, and giving ESAs more time to develop level 2 and level 3 would be tremendously beneficial.

As for the ESAs' mandate, the SMSG suggests including competitiveness of EU financial markets in the ESAs' mandate. This addition is deemed particularly appropriate to facilitate the achievement of CMU goals, as it relates to the ability of EU financial markets to attract international capital flows, and appears to be essential in the Brexit context.

As for the structure of the European supervisory architecture, the SMSG supports the objective of achieving a common supervisory approach. The SMSG recognizes that this is a continuous process, that in the long run might result in an integrated financial supervision. The SMSG believes that, at this stage, efforts should be concentrated on the success and efficiency of the coordination through the Joint Committee, that could bring targeted benefits.

I. Background

1. On 12 March 2021, the European Commission launched a targeted consultation on the supervisory convergence and the single rulebook. There has been considerable progress on both supervisory convergence and the single rulebook since the three European Supervisory Authorities ("ESAs") were created in 2011. Nevertheless, both require continued and appropriately targeted efforts to make further progress.

2. The European Commission's Capital Markets Union ("CMU") Action Plan ("AP") published on 24 September 2020 requires the Commission to work in Q4 2021 towards an enhanced single rulebook and to take stock of what has been achieved in supervisory convergence. The Commission will consider proposing measures for stronger supervisory coordination or direct supervision by the ESAs. In this context, the consultation seeks targeted views on certain aspects related to the 2019 ESAs review and contributes to a wider debate on supervisory convergence and the single rulebook.

3. The targeted consultation document includes questions related to two areas. The first area refers to the assessment of the ESAs and the recent changes in their founding regulations ("2019 ESAs review"), with questions specifically dealing with the following areas: the supervisory convergence tasks of the ESAs, the governance of the ESAs, their direct supervisory powers, the role of the ESAs as regards systemic risk. The second area refers to the single rulebook, with questions either related to the work done to achieve a single rulebook or related to general issues on the single rulebook.

4. The consultation document touches upon a number of relevant issues. The SMSG established a working group to discuss the topics covered in the targeted consultation document. This response summarizes the views of the SMSG with respect to selected issues raised in the consultation as well as other topics, not explicitly included in the consultation, deemed relevant by the SMSG as related to the CMU or the European supervisory architecture.

II. General comments

5. The SMSG believes that the recent changes to the ESAs Regulations brought rather positive results in different areas of ESMA remit. Examples of positive effects are the following: the reinforced supervisory convergence in terms of peer reviews (e.g., Wirecard, among others) and the increased scope of direct supervision of specific entities, the responsibilities of ESMA in sustainability and digital transformation (horizontal objectives of ESMA), the Union Strategic Supervisory Priorities for national competent authorities (NCAs) coordinated by ESMA (in 2021: costs and fees charged by fund managers; and improving the quality of transparency data reported under MiFIR).

6. The SMSG also notes that the assessment of the changes to the ESAs Regulations, as of now, may be premature in some respects. The new Regulations founding the ESAs were effective as of 1 January 2020 (i.e., just 16 months ago). In contrast, supervisory convergence is a long-term project. Additionally, the year 2020 was characterized by two enormous events, Brexit and Covid-19, making the context very peculiar. Furthermore, some changes to the ESAs Regulations are not yet effective: the new direct supervisory powers for ESMA on benchmarks and data service providers will only be effective on 1 January 2022.

7. Considering the factors mentioned above, the SMSG believes that a comprehensive assessment about the effectiveness of the changes to the ESAs Regulations would be more meaningful when additional time will have elapsed -since the changes entered into force. However, the SMSG also believes that some remarks can be proposed at this time already with respect to selected topics.

III. Comments on selected questions of the consultation document

Q.1.1.4: In the framework of the 2019 ESAs review. How do you assess the new process for questions and answers (Article 16b)?

8. The SMSG considers Questions & Answers (Q&As) to be an extremely helpful supervisory tool. Q&As are a form of guidance on the acts within ESMA's remit that enable uncertainties over the practical implementation of EU regulation to be addressed. The SMSG understands that Q&As are not legally binding and only the Court of Justice of the European Union can provide a definitive interpretation of EU law. Nevertheless, the SMSG believes that Q&As play an important role in inspiring the behaviour of market participants and are a key element in the harmonisation of market practices across the Union. Accordingly, the Q&A drafting process should be as inclusive as possible with respect to all relevant stakeholders and markets situations. Some NCAs apply the answers provided in the Q&A's very strictly whereas, despite their significance for the market, often no public consultation is performed to ensure that the Q&A does not inadvertently create operational or market practice issues. There is currently no impact analysis and no recourse in case of inconsistency with market practices effective in some markets. For all these reasons, unless specific reasons require prompt intervention, the SMSG believes that public consultation would be useful in the process of drafting Q&As.

9. The new provisions applicable to Q&As (New Article 16b of the ESAs founding Regulations) bring changes to the ESAs' processes (e.g., to set up a web-based tool) and require forwarding questions that involve the interpretation of Union Law to the European Commission. As a result of this new process ESMA has started informing market participants about three possible paths: questions for which a Q&A will be put on the agenda of ESMA's relevant Standing Committee; rejected questions, i.e. questions that were tabled for discussions in an ESMA Standing Committee and to which ESMA does not intend to provide an answer; and questions forwarded to the European Commission.

10. The SMSG observes that the new Q&A process is yet to be fully used. For instance, there have not yet been any public consultations on Q&As to date and the SMSG has not yet been consulted on any either. The SMSG suggests that, by contrast to the mechanism set out by Article 16b/4 that provides for consultation on Q&As upon request of 3 members of the Board of Supervisors, relevant Stakeholder Groups and consultative working groups should be consulted on a systematic basis. Exceptions could be foreseen if the Q&A has no material operational or compliance impact on market participants. In some cases NCAs could also be requested to gather input from the industry, although communication between market participants and NCAs on matters relating to the ESAs appears to be stifled by very strict confidentiality rules in some jurisdictions.

11. Additionally, the Q&A process should be complemented with the possibility for impacted parties to provide unsolicited feedback through the web-based tool used for the submission of questions. The web-based tool should accordingly be enriched to reflect the status of Q&As under consideration, together with planned timelines.

12. Q&As should be issued on a principle-based approach. In that respect ESAs should not be required to publish all answers on their homepages – unless they are applicable to other markets participants as well – as this might be in contrast with the provision of principle-based guidance and, at the same time, overburden ESAs.

13. The implementation periods for changes to the Q&As are not clearly defined. It is sometimes very challenging for market participants to apply the updates immediately, lacking other timing information[1]. The SMSG suggests considering ways to remedy to this.

Q.1.2.1: In the framework of the 2019 ESAs review. In your view, is the new mechanism of no action letters (Article 9a of the ESMA/EIOPA Regulations and Article 9c EBA Regulation) fit for its intended purpose?

14. The 2019 ESAs review introduced a new article entitled “No-Action Letters” (Article 9a of the ESMA/EIOPA Regulations and Article 9c EBA Regulation) into each of the ESA’s founding regulations.

15. The new articles provide the ESAs with two related powers. First, in exceptional circumstances, where the relevant ESA considers that the application of a legislative act in scope of the ESA regulations is liable to raise significant issues for specified reasons, it must, without delay, send a detailed account in writing to the National Competent Authorities (“NCAs”) and the European Commission of the issues which it considers to exist. The reasons specified in the regulations are the following: the Authority considers that provisions contained in such act may directly conflict with another relevant act; in the case of specified legislative acts, the absence of delegated or implementing acts raises “legitimate doubts concerning the legal consequences flowing from the legislative act or its proper application”; or the absence of guidelines and recommendations would raise practical difficulties concerning the application of the relevant act. Second, where the relevant ESA considers, on the basis of information received (in particular from competent authorities) that any of the relevant legislative acts raises significant exceptional issues pertaining to certain matters, it must without delay send a detailed account in writing to the competent authorities and the Commission of the issues it considers to exist. The relevant ESA can also provide the Commission with an opinion on any action it considers

[1] For example, the frequent updates of the ESMA Q&As on the EMIR reporting requirements resulted in sizable administrative burdens for market participants to implement the required processes.

appropriate, in the form of a new legislative proposal or a proposal for a new delegated or implementing act, and on the urgency of the issue. The relevant matters are the following: market confidence; consumer, customer or investor protection; the orderly functioning and integrity of financial markets or commodity markets; the stability of the whole or part of the EU's financial system.

16. The SMSG regrets that ESMA has used this tool only once in 2020 on sustainability-related disclosures for benchmarks, and then in 2021 ESMA reverted to using a supervisory statement to address the situation arising from the obligation to publish RTS 27 reports under MiFID II.

17. The SMSG observes that, in contrast to the Parliament's proposal and to the tools available to the authorities in other jurisdictions, the provisions do not give the ESAs the power to reform or suspend EU legislation unilaterally. Instead, they limit them to issuing non-binding recommendations, including suggestions for amendments to EU law for consideration by the Commission. As a consequence, no-action letters are not fully reliable for the financial industry, as they do not guarantee that the NCAs will act in a harmonized way and that market participants will be relieved from their obligations. The SMSG hence recommends that no-action letters come with an assumed agreement by NCAs to de-prioritise their enforcement actions related to the targeted rule, unless a NCA officially expresses its refusal to do so.

18. The SMSG also regrets that the no-action letters issued in the EU are not similar to those from the US CFTC, which are intended to provide a commitment to suspend the effectiveness of a legal provision. The SMSG highlights that a cross-jurisdiction comparative analysis would be inspirational with respect to this matter.

Q.2.4.5: 2019 ESAs' review. Please assess the significance of the recent changes in the composition, selection, term of office and advice of the stakeholders groups (Article 37 ESAs Regulations)?

19. The 2019 ESAs review introduced a change in the composition of the stakeholder groups ("SGs"). Specifically, the number of academics has decreased from 'at least 5' to exactly '4' and the number of industry side representatives of the SGs has been increased to 13, and also the number of other stakeholder representatives is fixed at 13 in all SGs. In December 2019, the SGs of the ESAs issued a joint position paper highlighting the positive contribution of academics in the functioning of the SGs, for their neutral and balanced approaches as well as for their role as mediators (SMSG ESMA20-06-2053).

20. The SMSG believes that this remark is still valid. Additionally, the composition of the users' side is somehow more heterogeneous than that of the market participants in terms of interests and constituencies (as it includes employees' representatives as well as investors and companies). In this respect as well it might be useful to reconsider the number of academics as neutral participants to the SGs discussions.

Q.3.3: How do you envisage the future scope of direct supervisory powers of ESMA or any other ESA? What principles should govern the decision to grant direct supervision to the ESAs?

21. The current situation is satisfactory as regards the supervision of market participants and financial institutions by NCAs. This structure ensures greater proximity to and knowledge of the market, its practices and the market participants and institutions themselves, and therefore a better supervision. Decisions on direct supervision by ESMA should therefore be taken on the basis of clear arguments

that direct supervision by ESMA will lead to higher supervisory quality than supervision by national authorities.

22. This being said, in a forward-looking perspective, the SMSG also believes that it would be worth exploring a potential expansion of ESMA´s direct powers in particular to some entities (e.g., CCPs) and to some areas such as: centralization of data used for the consolidated tape under MiFID; data collection for the purpose of reporting systems under MiFID (FIRDS); setting up and management of the European single access point (ESAP) for sustainable finance purposes; supervision of administrators of critical, pan-EU benchmarks. However, this should only be done in accordance with the subsidiarity principle, based on a cost/benefit analysis.

23. Furthermore, the Commission should consider a regulatory framework for European and global data providers, and possibly entrust their supervision to ESMA. Indeed, for instance, the transition to a low-carbon economy will require immense data sets to ensure an analysis of the three E, S and G aspects across all economic activities. Yet, regulators - including ESMA - have currently no powers to supervise providers of sustainability-related services (e.g., ESG ratings), and to question methodologies and analyses coming from entities that, additionally, find themselves in an oligopolistic situation.

Q.5.6: If you think of the Wirecard case as an example, how could supervision be improved in the field of auditing and financial reporting?

Q.5.9: Do you think that ESMA could have a role with regard to Directive 2006/43/EC (Audit Directive) and Regulation 537/2014/EU (Audit Regulation)?

24. In February 2021, the SMSG issued an own initiative report on the Wirecard case (ESMA22-106-3194). The SMSG believes that auditing played a key role in the Wirecard case and signals the need to consider a comprehensive reform of the EU audit rules. In its own initiative report, the SMSG invited the European Commission to carry out a reflection on the mission of auditors, with the aim to clarify their duties to report on irregularities and to grant the corresponding powers, such as the rights for auditors to access information, in particular from employees. In this context, forward-looking ideas may be inspirational (e.g., a rotation system in auditing teams[2], which is already required for ratings agencies, joint or shared audits and appropriate liability caps for audit firms). The separation of the audit arms from the consultancy units, announced in 2020 by the UK Financial Reporting Council, could indeed favour independence of the audit firms.

25. With respect to the role of ESMA, the SMSG believes that ESMA should develop audit standards to avoid conflict of interests. Additionally, ESMA might also have a role in the form of direct supervision of big auditing firms, at least when they provide services at pan-European level. The market for auditing services may be considered as EU wide and listed firms may be active in different EU countries. To avoid different treatments across jurisdictions, the Commission should consider to give ESMA supervisory powers in respect of large auditing firms active in the EU market.

Q.6.4.2: [I]n your view, could reducing divergences in rules at level 1 (legislation agreed by the co-legislators), as well as rules regarding delegated acts (regulatory technical standards) or implementation at level 2, (implementing acts and implementing technical

[2] Regulation No 537/2014 requires the rotation of key audit partners only.

standards) and/or level 3 ('comply or explain guidance' by ESAs) further enhance the single rulebook?

26. An appropriate balance of contents between level 1 and level 2 is key. Over the years, we have observed a significant increase of provisions being delegated to level 2 in many areas of financial regulation. Better regulation principles require that crucial issues should be tackled at level 1. If not, regulatory uncertainty may arise for stakeholders, ESAs, NCAs. The SMSG also believes that unbalances between level 1 and level 2 do not facilitate a common supervisory culture in Europe.

27. It is important that EU co-legislators ensure that all crucial political issues are dealt with at level 1. The temptation to overcome possible deadlocks at level 1 negotiations by deferring discussions on some key contentious matters and delegating them to level 2 should be avoided. Hence, the delegation of power must be clear, precise and detailed and may only aim to develop certain non-substantive elements of the legislative acts.

28. Reducing undue divergences within and across levels would certainly enhance the single rulebook. Confusion, conflicts and uncertainties between level 1, level 2 and level 3 are detrimental. The SMSG encourages continuous communication between ESAs' staff and the Commission's staff while drafting the rules. The Commission should be able to set and explain the spirit of level 1, when relevant, so as to smoothen the work done by the ESAs at a more technical level. The ESAs should also be able to inform and exchange with the Commission to ensure that the latter is aware of the main technical challenges while setting the course in level 1. Furthermore, giving ESAs more time to develop level 2 and level 3 would be tremendously beneficial: deadlines set in level 1 must be more realistic in this respect. Level 1 texts should allow sufficient time (i) for the ESAs to deliver adequate Technical Standards, and (ii) for the Level 2 texts to be implemented. The deadlines in Level 1 texts should be flexible rather than fixed, and the requirements in Directives and Regulations should become applicable only after a sufficient time for orderly implementation following the publication of related Level 2 measures in the OJ.

Q.6.8: As part of the Commission's work on enhancing the single rulebook under the Capital Markets Union project, do you consider that certain EU legislative acts (level 1) should, in the course of a review, become more detailed and contain a higher degree of harmonisation?

29. The SMSG points out that concomitant aspects are important for the proper functioning and development of securities markets and the achievement of a single market. This is sometimes the case in relation to criminal law, insolvency and bankruptcy law, and taxation of financial instruments and services. Progress should be made in being able to establish harmonized rules in any of these three areas, when securities markets policies and regulation so demand.

IV. Comments on other topics related to the CMU

A. To explicitly include competitiveness of the EU financial markets in the ESAs mandate

30. In order to contribute to the EU's global competitiveness, which is one of the key principles of the CMU[3], and considering the fact that Brexit has permanently changed the competitive landscape for financial markets, the SMSG believes that the objectives set to the ESAs by the founding regulations

[3] European Commission, *Building a Capital Markets Union*, 18 February 2015, page 5.

(Article 1.5 for ESMA), alongside the contribution to "ensuring the integrity, transparency, efficiency and orderly functioning of financial markets" and to "enhancing customer and investor protection" should include "ensuring the attractiveness of the Union's financial markets and the competitiveness of their players". This addition, which is particularly appropriate in the CMU context as it relates to the ability of the EU financial markets to attract international capital flows, is essential in the Brexit context. Additionally, the inclusion of the attractiveness of the EU financial markets in ESMA's mandate is all the more relevant as the UK FCA and the US CFTC already have similar mandates. Lastly, EU financial markets competitiveness is also related to EU financial markets stability and availability of funding for EU companies.

B. The structure of the European supervisory architecture

31. The European supervisory system consists of the three European supervisory authorities (EBA, ESMA, EIOPA). The Joint Committee of the European Supervisory Authorities was established to coordinate the cooperation between these three authorities and to ensure cross-sectoral coordination. In addition, level 3 committees are increasingly being used in practice to develop uniform positions across all sectors when needed. This rising need for cross-sectoral collaboration raises questions about how to improve the efficiency and effectiveness of the current European supervisory architecture. Some remarks in this respect are presented and discussed in the next paragraphs.

32. Promote the goal of Capital Markets Union. Better coordination through the Joint Committee can reduce supervisory differences that exist across sectors and thus promote the goal of a truly European capital market for its players on the supply and demand sides. Appropriate timeframes are needed to allow for the cross-sectoral step to be properly factored in. This applies to products and services from the securities markets or the insurance industry. In terms of the target direction the PRIIPs Regulation is a good example. The aim of the PRIIPs Regulation is to provide investors with EU-wide standardized information in order to enable cross-sector comparability of packaged investment products and improve investors' ability to take a well-founded investment decision. As outlined, the implementation of the PRIIPs legislation had a clear target. Nevertheless, the Level 2 implementation rules showed substantial differences between certain products, for instance between "pure" UCITS or UCITS packed as a life insurance product. This was also due to different interpretations by the authorities separately responsible for the securities and insurance sectors.

33. Promote the goal of a uniform standard in consumer protection and a level playing field. A coordinated approach in the development, interpretation and implementation of legal provisions allows a uniform consumer protection regardless of the sectoral allocation of the financial product or financial service. At the same time, this creates the basis for a level playing field with an efficient (and uniform, when meaningful) legal framework that eliminates undue distortions in competition. For example, current requirements are partially still structured differently by sector (e.g., the requirements for the admissibility of inducements under MiFID II and IDD).

34. Promote the objective of financial stability. In some cases, companies belonging to a financial conglomerate run businesses that can be assigned to different sectors for regulatory purposes. Better coordination through the Joint Committee would help to recognize interdependencies between these activities and thus to adopt necessary measures in a forward-looking or reactive manner in order to secure financial stability.

35. Promote effective and efficient supervisory organization. Some of the main strengths of better coordination through the Joint Committee would include a comprehensive view of financial stability issues, a decision-making process across all three ESAs requiring the direct cooperation between their chairpersons, effective procedures to deal with the situations being considered. Where possible, the Joint

Committee should rely on joint databases, joint procedures and joint data collection exercises, which are possible under the ESAs Regulations. Another aspect that may contribute to improve coordination and the development of a common supervisory culture is the exchange of staff between supervisors, as well as increased openness to exchanges of views across jurisdictions. This would be very helpful to progress towards a practicable harmonisation at a reasonable pace.

36. The assessment of the changes to the ESAs Regulations may be premature in some respects at this stage. The SMSG supports the objective of progressively achieving a more coordinated and common supervisory approach. The SMSG recognizes that this is a continuous process, that in the long run might result in an integrated financial supervision. At this moment, the efforts should be concentrated to the success and efficiency of the coordination through the Joint Committee, that could bring targeted benefits.

Adopted on 21 May 2021

[signed]

Veerle Colaert
Chair
Securities and Markets Stakeholder Group

[signed]

Giovanni Petrella
Rapporteur