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FESE Position
The Review of the European Supervisory Framework
November 2013

FESE has participated in the on-line surveys which were conducted by the European Commission and the European Parliament on the review of the supervisory framework of the EU over the summer of 2013, with a view to gathering views for the 2014 Review. The current document is a summary of the views expressed by FESE in these surveys. We intend to participate in the next stages of this process, namely the Commission's report and the Parliament's Own-initiative report. While our views are especially focused on the functioning of ESMA, we also provide selected views on the broader framework where we believe our members' experiences can be helpful.

I. SUMMARY OF FESE VIEWS

FESE members believe that ESMA has made a strong positive contribution since its creation, and that its overall framework of responsibility is good.

In summary, our observations are as follows:

- We believe that more involvement of ESMA in **Level 2** is a positive step. Under the MiFID I regime, FESE Members encountered significant problems with the lack of a convergent application of waivers from pre-trade transparency across Member States. These discrepancies raised significant issues in terms of individual investors' protection across Europe as well as the overall efficiency of the price formation process on European financial markets and resulted in an unlevel level playing field across European trading venues. FESE Members called for changes to these arrangements which, while leaving the application of waivers to national regulators, would have ensured that ESMA be granted with the power to issue binding decisions in respect of a Member State's application for a waiver for a venue in its jurisdiction. While not going this far, FESE is encouraged by the general direction of travel in the MIFID II / MiFIR texts which introduce ex-ante notification requirements on Member States to ESMA and give ESMA powers to mediate disagreements between national competent authorities on the waivers' authorization. In addition, we also very much support the requirement on ESMA to issue an annual report on the application of waivers in practice. This should help ensure proper convergence of the application of waivers from pre-trade transparency.
- A fundamental pre-requisite to achieving convergence is **consistent supervision**. An increased use of **binding mediation** in EU financial services legislation would improve the consistency of supervision and thereby ensure consistent outcomes across all jurisdictions.
- The current **governance structure** with respect to the supervisory board and the management board does not guarantee the efficiency of the acts and a fair degree of independence to the ESAs because it is excessively influenced by the interests of single national authorities. We recommend a structure similar to the one used by the ECB's Governing Board and General Council.
- ESMA needs to improve its **effectiveness in protecting investors**. ESMA can make further progress in the area of detecting and preventing the various types of abuse of clients, such as misleading information, inducements and biased advice. ESMA to collect, analyse and report more data on consumer trends.
- ESMA has the power to **ban certain products** but has not made extensive use of this power. Stronger action of ESMA, possibly including a ban on a product, would have been useful, as in the case of the concerns raised about the selling of CFDs to retail investors in Poland in 2012.

- ESAs (and the ESRB) need to be able to declare **the existence of an emergency** when truly needed.
- **More resources** are needed to fulfil ESMA's mandate in full and also to strengthen ESMA's independence.
- ESMA should have wider **standard-setting powers** by being able to adopt not only guidelines and recommendations but also standards on topics indicated in Art 1(3) (i.e. for ESMA, corporate governance, auditing, and financial reporting or takeover).
- The application of ESMA's **guidance** of all kinds should become public more in advance and be made more transparent.
- The result of the evaluation process that is part of the **peer review** foreseen in Art. 30 should be disclosed publicly and not be made subject to the agreement of the competent authority that is the subject of the peer review in order for the peer review process to have greater effect.
- We would in principle support the extension of ESMA's **direct supervision** to other entities subject to a clear framework to determine the entities.
- ESMA has been doing a good job in terms of involving a range of different points of view and employing a **transparent decision-making process**. However, there is still potential for **improvement.** In particular, we support: a greater outreach to retail groups, greater ESMA transparency about whom they consult in the industry and how at any level, additional steps to ensure that consultations are efficient, more realistic deadlines for consultations, a greater effort to include the points of views of investors in the industry groups set up to advise the Standing Committees, and a more transparent process for the setting up of the composition of the Standing Committees.
- We believe that the ESMA Securities Markets Stakeholder Group (SMSMG) has been very useful, in particular with regard to their own-initiative work such as their report on SME Finance and the exchanges of views on market developments which allowed the SMSG to alert the ESMA Management and the Supervisory Board to key new risks, such as the discussions on self-placement, crowd funding and CFDs. To be even more helpful, this Group needs more **administrative support.**

II. DETAILED VIEWS BY TOPIC

1) Convergence

We believe that more involvement of ESMA in Level 2 is a positive step. The experience of FESE Members in respect of the application of MIFID I and the measures being taken to address these issues in the MIFID II / MiFIR discussions are particularly relevant in respect of convergence. Under the MiFID I regime, FESE Members encountered significant problems with the lack of a **convergent application of waivers from pre-trade transparency** across Member States. Under MIFID I the application for waivers from pre-trade transparency is done at a national level. As these waivers are currently granted by national regulators, discrepancies exist in respect to their application, with some regulators appearing more lenient than others. In other words, while some regulators favour a strict application of pre-trade transparency waivers so as to promote a high level of pre-trade transparency, and to limit their application only to legitimate circumstances, other regulators tend to grant waivers on a less stringent basis. These discrepancies raise significant issues in terms of individual investors' protection across Europe, but also in respect to the overall efficiency of the price formation process on European financial markets and result in an unlevel level playing field across European trading venues. FESE Members called for changes to these arrangements which, while leaving the application of waivers to national regulators, would have ensured that ESMA be granted with the power to issue binding decisions in respect of a Member State's application for a waiver for a venue in its jurisdiction. While not going this far, FESE is encouraged by the general direction of travel in the MIFID II / MiFIR texts which introduce

ex-ante notification requirements on Member States to ESMA and give ESMA powers to mediate disagreements between national competent authorities on the waivers' authorization. In addition, we also very much support the requirement on ESMA to issue an annual report on the application of waivers in practice. This should help ensure proper convergence of the application of waivers from pre-trade transparency.

2) Consistent supervision

FESE notes that a fundamental pre-requisite to achieving convergence is consistent supervision. An increased use of **binding mediation** in EU financial services legislation would improve the consistency of supervision and thereby ensure consistent outcomes across all jurisdictions.

3) Independence and accountability, governance and decision-making

There is a weakness in terms of the credibility of governance, as it is difficult for regulators to judge their peers. The resolution of disputes will be difficult in the future as ESMA gets more powers. The Resolution of disputes is too lengthy. ESMA is not always able to enforce its view on other regulators.
We have the following recommendation: The supervisory board and the management board are composed of national competent authorities who are (in the supervisory board) the only voting members. This kind of composition does not guarantee the efficiency of the acts and the fair grade of independence to the ESAs because it is excessively influenced by the interests of single national authorities. When the ECB was created, the choice was to add six 'other' members to the Governors of Central Banks in the Governing Board and in the General Council: the six independent members, appointed by the European Council, constitute the executive board of the ECB. A similar choice would be more appropriate in order to overcome the resistance of some national competent authorities to promote, through a central body, convergence in regulation and supervision.

4) Consumer protection

Related to several of the subjects above (eg direct supervision and product banning powers as well as funding), we believe that ESMA needs to improve its effectiveness in protecting investors. ESMA can make further progress in the area of detecting and preventing the various types of abuse of clients, such as misleading information, inducements (for example, the French Regulator announced that two thirds of intermediaries did not comply with MiFID inducements rules) and biased advice. For example, although Article 9 Para 1(a) requires ESMA to collect, analyse and report on consumer trends, ESMA has not been able to devote much focus to this topic in its general trends report ('Trends, risks and vulnerabilities in financial markets'). In addition to improvements in the clarity its mandate and governance, ESMA would need to have more funding in order to have more effectiveness in consumer protection.

5) The ESA mandate

- **Product banning powers**

ESMA has the power to ban certain products but has not made extensive use of this power. There remain questions about when and how this power should be used. For example, despite clear public concerns about the rate of investor losses related to CFDs (particularly in Eastern European Member States, where up to 80% of the investors were found to be losing all their investments in CFD), ESMA has only taken very limited steps, issuing a warning first (published on the ESMA website and not visible to most investors) and then taking the step of translating it into the language of one of the Member States most affected (Poland). Other steps that might have been helpful - such as requiring the CFD providers to make the warning prominent or banning certain types of CFDs – remain to be taken. In addition to

the high rate of investors losing their investments in CFDs, there was even confusion about whether CFDs were covered by the current MiFID or not. This made it more difficult for the public to know what kind of protection they were entitled to. Hence this was an instance where stronger action of ESMA, possibly including a ban on a product, would have been useful. One of the legal obstacles that may be necessary to address is that, despite the clear reference to consumer protection and financial activities in the title of Article 9, Para 5 of this article does not allow ESMA to prohibit or restrict any activities *on the basis of investor protection*; rather, the activity must threaten the orderly functioning or integrity of financial markets or the stability of system. This is too narrow a scope (even if, in the context of the financial crisis, many products and activities harmful to investors also did threaten the system). We believe that this power must be clarified. Naturally, the power of prohibition should be well framed and used only as a last resort, but it must be better defined to become a viable option. In this sense, ESMA should be able to take all the necessary steps to protect the "health" of the financial sector clients, much as in the pharmaceutical industry, in which no toxic or harmful drug would be allowed, and all products would have to be labelled correctly.

- **Emergency situations**

Regarding the action in possible emergency situations, which may arise all of a sudden, a critical issue is the lack of possibility for an ESA (and the ESRB) to declare the existence of an emergency: the ESA should rather 'issue a confidential information to the Council (…) The Council shall then assess the need for a meeting' and then inform the Commission and EU Parliament (Art. 18). While this cumbersome process may be appropriate for the evaluation of a macro-systemic emergence, it is obviously incompatible with the timing of a micro-emergency situation which may require ESMA, for example, to decide on a Sunday night to suspend trading of certain classes of financial instrument or to limit short selling.

6) Resources

ESMA has made great efforts to increase its staff. However, we believe that its staff still needs to grow if it is to fulfil its mandate in full. More resources are needed also to strengthen ESMA's independence.

7) Cooperation and coordination

We believe that ESMA has done a positive job coordinating in crisis situations (e.g. short selling). However, we believe that there is a need for a better balance between regulation and supervision: supervision should be stepped up to ensure harmonised implementation across jurisdictions. That will make the cooperation and coordination easier.

8) Should ESMA have wider standard-setting powers?

Currently ESMA can only adopt guidelines and recommendations on topics indicated in Art 1(3) (i.e. for ESMA, corporate governance, auditing, and financial reporting or takeover) because only the topics listed in Art. 1(2) are explicitly allowed for standards. FESE supports that ESMA gains wider standard-setting powers in these additional areas.

9) Enforceability of ESMA's standards, recommendations and guidance & the Peer review process

There is a certain degree of variation in the enforcement of ESMA's standards, recommendations and guidance. When ESMA issues guidance, its enforcement should become more consistent across Europe. To achieve this objective, the application of ESMA's guidance of all kinds should become more in advance and more transparent. In this regard, **the peer review foreseen in Art. 30** is very important

especially because it can be made public. But the result of the evaluation process may be disclosed publicly only subject to the agreement of the competent authority that is the subject of the peer review: We believe that this limitation may need to be lifted in order for the peer review process to have greater effect. We also support greater international coordination with other regulatory bodies.

10) Direct supervision by ESMA

Regarding direct supervisory powers on entities with Community-wide reach or economic activities with Community-wide reach (as it was foreseen for all the ESAs in the Commission proposal (Art 6(3)), ESMA retained this power in relation to CRAs and later trade repositories. This power is necessary to allow ESMA to exercise certain other powers in Article 9). We would in principle support the extension of ESMA's direct supervision to other entities subject to a clear framework to determine the entities. In addition, we believe that ESMA should conduct cross-border market surveillance and acquire the necessary systems and staff to make this possible. These powers should only be exercised in a way that does not create fiscal expenditures for the national authorities.

11) Consultation and communication

ESMA has been doing a good job in terms of involving a range of different points of view and employing a transparent decision-making process. However, there is still potential for improvement. In particular, we see some necessary changes as follows:

- In general, there is a need for a greater outreach to retail groups.
- ESMA should be more transparent about whom they consult in the industry and how at any level. ESMA sometimes issues 'informal consultations' with only a certain part of the industry to later release the official consultations. For example, ESMA could follow the CFTC example by publishing on its website every representative of a group they meet with and the agenda of the meeting.
- ESMA could take more steps to ensure that consultations are efficient. ESMA sometimes organises meetings with industry participants with no agenda, only a topic. The industry cannot therefore prepare to provide constructive input to ESMA.
- In the same vein, deadlines for consultations are generally seen as too short (sometimes, 2 or 3 weeks for a substantive piece of Level 2 legislation). Although the overall process in not in ESMA's hands, ESMA needs to do more to allocate sufficient time to consultations and not force the industry to bear the burden of unrealistic timetables.
- ESMA should make a greater effort to include the points of views of investors in the industry groups set up to advise the Standing Committees.
- The setting up of the composition of the Standing Committees should be more transparent.

12) The ESA stakeholder group

We believe that the ESMA Securities Markets Stakeholder Group (SMSMG) has been very useful. In particular, we believe that their own-initiative work (such as their report on SME Finance) was particularly useful. Also very important were the exchanges of views on market developments which allowed the SMSG to alert the ESMA Management and the Supervisory Board to key new risks, such as the discussions on self-placement, crowd funding and CFDs. To be even more helpful, this Group needs more administrative support.