

FESE response to ESMA consultations on Guidelines on periodic information and supervisory expectations for the management body for some supervised entities

Brussels, Wednesday 17th October 2024

ESMA consultation on Guidelines on the submission of periodic information to ESMA by BMAs, CRAs and MTIs

Q1. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the board and internal governance documents? Please elaborate on the reasons for your response.

FESE does not agree with the proposal that the drafted expectations should be uniformly applicable to all entities currently supervised by ESMA or, in the case of BMR, by NCAs, nor that they should apply to any future mandates ESMA might be granted in terms of supervision. While supervised entities could be required to make available a reasonable description of their governance bodies and internal controls, as per the relevant provisions of the regulation to which they are subject, requiring submission to ESMA of internal documentation potentially containing information of a sensitive nature – such as minutes of board meetings and copies of documents discussed in the meetings – goes beyond what is necessary for the purposes of the regulation.

We have concerns about the broad scope underlying the proposed reporting requirements, including regarding “organisational charts” (e.g., examples of functions, coverage, scope). For example, requiring reporting at the “group” level on Compliance and Risk Management goes beyond the bounds of the respective regulations to which the supervised entities are subject. Additionally, distinguishing between a “compliance work plan” and a risk-based plan is crucial to ensuring that the proposed reporting is workable and proportionate to the scope and reporting burden envisioned by the authorising legislation.

Finally, where definitions are ambiguous, it is not strictly necessary for ESMA to make them more granular. Similarly, where definitions risk being overly broad (e.g., coverage of “all staff” for a supervised entity or at the group level), as proposed under 5.3.1 item 3, we encourage ESMA to provide flexibility for supervised entities to adapt the definitions to fit their particular structure and business models (e.g., permitting definitions to be narrowed to *relevant* staff in line with a risk-based supervisory approach). This will help ensure workability.

Q2. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the internal controls documents? Please elaborate on the reasons for your response.

Q3. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the information technology and security documents? Please elaborate on the reasons for your response.

Many of the supervised entities covered by the Consultation are not subject to DORA. However, the proposed reporting requirements (e.g., reporting on ICT risk management, ICT risk profile; audit of ICT risk management framework; summary of remediation actions) subject the supervised entities to DORA requirements. This proposal exceeds the scope agreed upon during the legislative process, and we have significant concerns about these requirements undermining the risk-based approach envisioned by the co-legislators in finalising DORA. Further, we are mindful of the significant practical challenges and the quickly on-setting compliance dates resulting from DORA implementation, which are further compounded by the already subjective nature of some of the DORA definitions.

Accordingly, we stress the need to maintain the notion of proportionality inherent to the DORA text by not introducing new and additional requirements for the supervised entities covered by the Consultation. We also stress the importance of further DORA-related clarifying technical standards and directives before considering extending DORA-related provisions to new entities, and the risks of not doing so.

Q4. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the audited financial statement documents? Please elaborate on the reasons for your response.

Q5. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the BMAs periodic information documents? Please elaborate on the reasons for your response.

No. In general, we would question the need to require BMAs to report to ESMA in addition to NCAs. Whether a BMA is regulated at the NCA or EU level, we also have concerns about the proposed reporting requirements that go beyond the BMR legislative text.

- Items 14, 15 and 16 [Methodology and external audit]: The suggestions laid out regarding ESMA's role vis-a-vis operations and benchmarks, as well as methodologies and external audit reports, reflect activities that are already carried out by NCAs [in some Member States]. The necessity of both NCAs and ESMA to conduct such activities may be questioned. Further, BMR does not expressly mention audited statements, so the proposed reporting requirement under item 13 goes beyond the authorising text. With respect to item 15 specifically, we also question the need to provide reporting on "resourcing: methodologies" at the group level, when reporting at the level of the supervised entity would provide the relevant information and not risk going beyond the regulatory scope of BMR.
- Item 17 [BMR Staff Numbers & Other Indicators]: The proposed requirement for BMAs to submit information on FTE allocation through a standardised template represents a practically inapplicable one-size-fits-all approach. It is for companies to decide how a job can be conducted satisfactorily.
- Item 18 [Revenues and costs]: While ESMA-supervised BMAs make available to ESMA some information on their revenues, primarily for the purpose of calculating supervisory fees, BMR does not expressly mention reporting on revenues and costs. We question why the 'financial soundness' of BMAs would be an issue for ESMA as a supervisory body. Besides that, financial soundness is not obviously determined. In addition, it is not understood which conflicts of interest could arise from BMAs' activities. BMAs are already audited and supervised at the national or EU level. We

believe this proposed requirement goes beyond the authorising legislative text and beyond what is necessary for the purposes of BMR or ESMA supervision.

- Item 39 [potential and actual cases of non-compliance]. It is unclear what is meant by “possible” non-compliance. We reiterate the importance of directly linking the proposed requirements in the Consultation to the BMR text in order to align legislative intent with ESMA supervision. Further, with respect to “actual” breaches, we believe a reasonable definition to help clarify the threshold for these types of breaches is necessary and helpful; for example, the threshold could be linked to a materiality threshold.

Some of the proposed requirements refer to reporting templates, though it is not clear what these templates would look like. While the requirement to provide reporting in a machine-readable format is noted, we have some reservations about the associated costs and implementation practicalities.

We appreciate that ESMA wants to learn more and understand the process of benchmark provision. However, requiring BMAs to report the above-mentioned, to both an NCA and ESMA, would entail unnecessary double-reporting.

Q6. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the CRAs periodic information documents? Please elaborate on the reasons for your response.

Q7. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the DRSPs periodic information documents? Please elaborate on the reasons for your response.

Q8. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the SRs periodic information documents? Please elaborate on the reasons for your response.

Q9. Do you agree with the proposed approach regarding the content and the frequency of the reporting of the TRs periodic information documents? Please elaborate on the reasons for your response.

Q10. Do you agree with the proposed approach regarding the reporting of the material changes to the conditions for initial registration? Please elaborate on the reasons for your response.

Q11. Do you agree with the proposed approach regarding the reporting of the cross-sectoral notifications not related to the material changes to the conditions for initial registration? Please elaborate on the reasons for your response.

Q12. Do you agree with the proposed approach regarding the reporting of the BMAs ad-hoc notifications? Please elaborate on the reasons for your response.

Q13. Do you agree with the proposed approach regarding the reporting of the CRAs ad-hoc notifications? Please elaborate on the reasons for your response.

Q14. Do you agree with the proposed approach regarding the reporting of the DRSPs ad-hoc notifications? Please elaborate on the reasons for your response.

Q15. Do you agree with the proposed approach regarding the reporting of the SRs ad-hoc notifications? Please elaborate on the reasons for your response.

Q16. Do you agree with the proposed approach regarding the reporting of the TRs ad-hoc notifications? Please elaborate on the reasons for your response.

ESMA consultation on supervisory expectations for the management body

Q1. Do you agree with the proposed scope of application of these supervisory expectations? If not, please explain.

FESE does not agree with the proposal that the drafted expectations should be uniformly applicable to all currently ESMA-supervised entities nor that they should be applicable to any future mandate ESMA might be granted in terms of supervision.

We do not see any legal basis granting ESMA the authority to regulate governance arrangements at such a granular level for Credit Rating Agencies, Benchmark Administrators, Third-Country CCPs, Data Reporting Service Providers, and Trade Repositories, nor for EU Green Bond external reviewers, ESG rating providers and Consolidated Tape Providers (CTP) being added to ESMA's supervisory remit. Specifically, the Level 1 text of these legislative acts does not include any requirements in relation to an administrator's management body, nor does it allow ESMA to oblige supervised entities to set up a management body.

The general statement that all these entities are under ESMA supervision does not justify such far-reaching and detailed regulatory powers. The scope of supervisory powers and their limitations are prescribed by the respective level 1 legislation. This is particularly relevant as the draft guidance outlines clear expectations rather than non-binding guidelines for market participants. Therefore, ESMA should follow the governance rules set out in the respective level 1 texts (e.g., EMIR 3.0), which are specifically designed for each financial market participant. Against this background, we are concerned that governance rules are being introduced through level 3 measures, while instead should have been addressed at the level 1 stage, as they involve substantive elements of regulatory frameworks like EMIR or BMR. We stress that ESMA be mindful of the principle of proportionality based on the nature, scale and complexity of the activities of a supervised entity.

In addition, FESE does not believe it is appropriate to extend the scope of ESMA's proposed supervisory expectations to recognised or equivalent third-country entities. Doing so would be inconsistent with the EU's equivalence/recognition regime and would amount to regulatory overreach if ESMA were to impose governance arrangements with extraterritorial effect, in parallel to the supervisory frameworks of third countries. The equivalence granted by the EU Commission is based on the assessment that a third country's regulatory and supervisory framework achieves outcomes similar to EU law, ensuring a level playing field and trust in the third country's legal system. ESMA would be overstepping its powers if it were to impose governance regulations with extraterritorial effect next to, for example, the supervisory expectations of authorities like the Bank of England (BOE). Such an approach would not only be duplicative but could also potentially conflict with the third country's own supervisory expectations.

The comments provided below regarding other aspects of ESMA's consultation are made without prejudice to this position.

Q2. Do you agree with the proposed approach to proportional application? If not, please explain.

We understand that as ESMA's supervisory mandates have grown to cover a broader set of entities, ESMA aspires to provide all its supervised entities with the same reference point regarding governance arrangements. However, we want to highlight the necessity for an individualised, entity-specific approach by ESMA, as no single governance structure is suitable for each and every entity. The entities under ESMA's supervision are very distinct

from one another and require different approaches. Business activities and risk profiles vary significantly between CCPs, Credit Rating Agencies, Benchmark Administrators, Data Reporting Service Providers, and Trade Repositories. Governance arrangements need to be designed to suit the specific characteristics of each supervised entity, something a “one-size-fits-all” approach cannot ensure.

This is even more important as additional DRSPs will emerge in the European Union, and especially – for the first time – European CTPs. ESMA should carefully calibrate the necessary scope and approach, emphasising where it is sensible and necessary.

To ensure the practicability and fit-for-purpose requirements, we stress the following overarching points:

- Flexibility is especially necessary for matters relating to corporate governance to allow autonomy for supervised entities and to create more legal certainty in the application of the proposed guidelines. For example, different supervised entities are subject to varying member state and non-EU company laws or national codes of conduct, which may cover criteria as specific as the independence of members of a management body.
- The detailed criteria of the Consultation should be modulated by firms’ existing legal obligations and business and compliance needs. The Consultation requires specific supervisory arrangements, starting with a distinction between the management and supervisory functions of a management body and including training and diversity recruitment policies that are not addressed in Level 1 or Level 2 legislation for some regulated activities, such as those of external reviewers and ESG rating providers. ESMA seeks to harmonise what has not been harmonised by Level 1 texts. It is also unclear how these guidelines will intersect with the Internal Control Guidelines ESMA is working on for the firms it supervises.
- We appreciate that the Consultation takes into account group structures and that ESMA states it is mindful of organisational structures and arrangements when assessing an entity. In that regard, the application of the requirements on individual and consolidated levels could be clarified to avoid duplication and ensure that subsidiaries can benefit from a right-sizing of requirements, as long as their governance arrangements are reasonably designed to achieve the regulatory objectives.

Q3. Do you agree with the expectations regarding the role and responsibility of the management body? If not, please explain.

FESE welcomes ESMA’s approach of not prescribing either a unitary or dual board structure, but that the expectation is to embrace all existing structures, as long as there is a clear distinction between executive management and non-executive supervisory functions, with their respective duties clearly defined. FESE also agrees with ESMA’s view that oversight and challenge can only be effective when the supervisory function has a complete understanding of the entity it oversees.

However, efficient working processes and an effective division of functions require the executive function of the management board to make decisions—sometimes on short notice—in the day-to-day management of the company and in implementing strategy, where the supervisory function might be informed later point in time.

Further, ESMA states in paragraph 16 (page 9 of the Consultation Paper) that “*the management body is the ultimate decision-making body of an entity and oversees and provides challenge to the senior executives.*” FESE would like to note that in some matters, the supervisory function of the management body may indeed be the ultimate decision-making body of an entity; however, for other fundamental matters, the shareholders’ meeting may hold that role. However, there is scope for interpretation,

which (as noted in Q1) could potentially give rise to conflict with the third-country authorities' own supervisory expectations for financial entities, including governance. It is not clear from the document whether ESMA would, in the event of a conflict or potential conflict, defer to third-country authorities (e.g. the BOE). This should be clarified.

Q4. Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain.

Q5. Do you agree with the expectations regarding operation of the management body? If not, please explain.

Regarding the operation of the management body, FESE generally agrees with ESMA's general approach to the independence of the management body and that it should operate in a way that promotes its members' independence.

As previously defined by the EU Commission in Recital (7) of its Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC of 15 February 2015), independence is the absence of any material conflict of interest. ESMA should bear this in mind when exercising its supervision. Hence, we want to highlight the importance of robust conflict-of-interest policies and that ESMA should promote further safeguards when supervising the governance structure of an entity. ESMA should expect the management body to adhere to a strict conflict-of-interest policy and that suitable measures to mitigate potential conflicts are implemented, including, as necessary, Chinese Walls and strict adherence to the Arm's-Length Principle. This is especially important as the first European CTP will soon be operating, presenting several challenges regarding possible anti-competitive effects and conflicting interests in context with other market participants and service providers.

Furthermore, FESE does not agree that pre-meetings of the board or committees should be "recorded,"; this would undermine the valuable distinction between meetings (which are minuted) and pre-meetings (which are not). The purpose of a pre-meeting is to allow the chair or presenter to walk through the material with select attendees in a safe environment before the meeting itself. Questions and issues can be discussed, and the meeting material and attendees can be adjusted as necessary in advance of the meeting to ensure a more successful outcome. Decisions and follow-up actions should be made at the meeting itself (not the pre-meeting), and FESE agrees that these should be tracked and reported through appropriately detailed minutes.

Q6. Do you agree with the expectations regarding the role of the chair? If not, please explain.

FESE agrees with most of the expectations regarding the role of the chair of the management body in its supervisory function—in some entities, the supervisory board. By design, in a dual board structure with an executive board and a supervisory board, the role of the chair of the supervisory board is always non-executive, maintaining sufficient distance and independence from the day-to-day management of the regulated entity.

However, in some governance structures, members of the supervisory board are recommended by shareholders according to a certain distribution key and then appointed by the general meeting of shareholders. The supervisory board members then appoint a chair and a deputy chair from among themselves. Therefore, ESMA's expectation that the chair should ensure that the composition and collective skillset of the management body remains appropriate, for the nature, scale, and complexity of the business, cannot be

fulfilled. The chair usually has no influence over which candidate is nominated by which (group of) shareholder(s) and appointed by the general meeting.

Q7. Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain.

See Q5 as regards pre-meetings.

Q8. Do you agree with the expectations regarding the effectiveness and composition of the management body? If not, please explain.

FESE generally agrees with the approach taken by ESMA regarding the effectiveness and composition of the management body. Regarding the regulatory review promoted by ESMA, it is also important to consider how the company engages with its shareholders and other key stakeholders. The company should proactively seek feedback on governance issues and other relevant topics. There should be a clear line of responsibility to maintain the effectiveness of the management board.

Furthermore, we appreciate that ESMA recognises that establishing additional committees with an advisory function may be appropriate for some organisations but may not be proportional for many entities under ESMA's supervision. In some cases, this can lead to fragmentation of decision-making. To that end, we agree that shareholder and stakeholder engagement should not hinder the management body from exercising its role. Decision-making and necessary discussions must remain with the management board. Therefore, ESMA should continue to promote clear voting and advisory rights to maintain a well-balanced effectiveness of the management body.

As we see a connection to the MiFIR Review and the different consultation packages by ESMA related to the new DRSP regime and various views on governance topics, we want to highlight the organisational structure as outlined by lawmakers and years of practice. It must be noted that, in general, there is no need to include representatives of the state or supervisors on the boards or committees of a private company. In the interest of the markets, the supervisor's aim should be to avert damage to the public and the financial markets, hence the supervisory comprehensive rights, especially to access information on the supervised entity.

Q9. Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain

Q10. Are there any topics or areas that you would have expected to be covered or covered in more detail? If so, please explain

FESE wants to highlight further necessary aspects when establishing expectations for the management body. As stated by ESMA, the management body needs to maintain independence, and its members need suitable knowledge of the company and regulatory requirements.

Due to its importance, we want to reiterate the need for robust conflict-of-interest policies within the management board (equally for both the management and supervisory functions). The management board needs to be able to make independent and well-informed decisions; therefore, we propose reviewing whether the establishment of committees would be appropriate. Furthermore, the management body needs to work with clear responsibilities and a strong commitment to its regulatory requirements.