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EUROPEANISSUERS' VIEWS ON THE GOVERNANCE, ACCOUNTABILITY AND FUNDING OF THE EUROPEAN SUPERVISORY AUTHORITIES (ESAs)

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INTRODUCTION

EuropeanIssuers, representing the interests of European publicly quoted companies, welcomes the upcoming European Commission White Paper and accompanying consultation on the funding and governance of the European Supervisory Authorities (ESAs). Given the challenges faced, we believe that ESAs have performed rather well. Nevertheless, certain improvements are needed to ensure the well-functioning and credibility of the European System of Financial Supervision. Given the strong links between the funding model, the governance and accountability of the authorities, the upcoming consultation should not consider the ESA's funding model in isolation, but take this opportunity to foster European Supervisory Authorities` governance and accountability. It would be useful if the consultation also looked at the functioning of ESAs and possible ways to improve the opportunities for stakeholder engagement.

Against the background of the remit of our organization, our comments are mainly concerning the European Securities and Markets Authority (ESMA).

SUMMARY

Given the strong links between the funding, governance, accountability and functioning of ESAs, we suggest that the upcoming consultation on the revision of ESAs addresses the following aspects:

1. Accountability

Scrutiny of ESMA`s activities by the European Commission, the European Parliament and the Council could be further enhanced. For instance, more frequent reports from the ESAs to the European Institutions and earlier participation of the institutions in the drafting phase could be considered

2. Governance

The consultation should provide opportunity to comment on the current governance arrangements and possibilities for improvements.

a) The composition of the "Management Board" and "Board of Supervisors" does not necessarily guarantee the efficiency of ESAs decisions, nor the required degree of independence from the National Competent Authorities.

b) Decisions should be based on the broadest possible input. Greater industry involvement, adequate opportunity to comment on Level 2/Level 3 measures needs to be guaranteed and transparency enhanced.

c) More transparency would also be desirable regarding the elaboration of the work programmes and the priorities of the ESAs and how they correspond with the budget.

d) ESAs should solicit comments by stakeholders when drafting EU peer reviews in order to receive useful comments other than those coming from the reviewed authorities themselves.

3. Appropriate balance between Level 1 and Level 2:

Legislative bodies of the EU should ensure that all crucial political issues of the respective dossier are tackled on level 1.

4. Better Functioning of the ESAs

Considering the abundance of legislative acts of the ESAs, they should be part of the European Better Regulation Agenda. Improvement is specifically needed regarding the timeline for the adoption of Level II measures.

5. Funding

EuropeanIssuers strongly opposes to change the current ESAs funding model. The current model balances contributions and control mechanisms between Member States and the European Union in an equal and fair manner. Any alteration would threaten the already relatively low level of democratic legitimacy of the ESAs.

Also, it should be borne in mind that any considerations on changes to the funding of ESAs should not be made before ***the supervisory governance has been improved and the above-cited deficiencies remedied.***

FULL POSITION

EuropeanIssuers follows the upcoming consultation of the European Commission on the governance, accountability and funding of the European Supervisory Authorities (ESAs) with great interest. Given the constantly increasing impact of ESAs` activities on regulation affecting companies, we deem the consultation an excellent opportunity to address issues, which could in our view be improved within the current ESA framework to ensure that ESAs are able to effectively fulfil their mandate.

Notwithstanding the importance of the ESAs, in particular their ability to foster confidence in the financial system as well as to preserve financial stability, the past has shown that ESAs have on several occasions overstepped powers conferred to them, which has raised questions of governance and accountability (see annex for examples). **Thus, it is of utmost importance that the upcoming consultation focuses not only on the funding aspects, but also addresses ESAs governance and accountability, which are closely linked to the funding.** Also in this context, there is the necessity of having a general reflection on the architecture of the European Supervisory framework, in particular the relation and competences between the ESAs and the National Competent Authorities (NCAs).

EuropeanIssuers therefore believes that the upcoming consultation offers opportunity to comment on the issues outlined below. Please note that our comments primarily relate to the European Securities and Markets Authority (ESMA), by whose measures members of EuropeanIssuers are mostly affected**.**

1. Accountability

One part of the consultation should be dedicated to enhance scrutiny of ESAs` activities by the European Commission, the European Parliament and the Council in order to better being able to hold ESAs accountable for their work. The European Institutions are involved in many acts of eg ESMA and thus ultimately assume political responsibility for ESMA`s activities. The European Institutions will however only be able to live up to their political responsibility if they are provided with adequate tools to thoroughly scrutinize ESMA`s activities.

The options that could be considered are:

a) An extension of the time frame to examine the draft technical standards for the European Parliament and the Council in case the Commission endorses technical standards submitted by the ESAs without any revision. The one month period can be too short to scrutinize the texts, given the complexity of most of the drafts. The European Parliament and the Council must be given enough time to consider the draft, otherwise the process loses democratic legitimacy.

b) Participation of the institutions already in the drafting phase. Regular informal exchange between the EU Institutions and the ESAs – e.g. as established between ESMA and the ECON-committee of the European Parliament since 2012 – help in that regard. The consultation might probe an idea of ESAs forwarding preliminary versions of draft regulatory technical standards, working documents or non-papers to at least the rapporteur on the file in the Parliament and the chair of the working group of the respective Council Presidency before they are approved by the Board of Supervisors (BoS). Such an approach would help the EU institutions better follow the discussions.

c) In our opinion there is room for improvement of how hearings of the chairs of the supervisory authorities before the European Parliament are conducted. The current procedures regarding such hearings do not allow for a proper debate - MEPs cannot ask questions related to the responses provided by the chairs to the previous questions. We believe the procedure could be improved in that respect.

d) Introduction of a scrutiny of ESAs guidelines by the EU institutions regarding ESAs` guidelines to guarantee effective control. ESMA's guidelines may be perceived as have gained a factual binding effect as many National Supervisory Authorities implement them at the national level. While the guidelines are developed without any involvement of the EU regulator.

2. Governance

a) Composition of the "Management Board" and "Board of Supervisors"

The consultation shall provide opportunity to comment on the current governance arrangements and possibilities for improvements. For instance, our members feel that the current composition of the "Management Board" and "Board of Supervisors" does not necessarily guarantee the efficiency of ESAs decisions, nor the required degree of independence from the National Competent Authorities, as it embeds the interests of national authorities.

Currently, the Board of Supervisors and the Management Board are composed of representatives of the NCAs (plus the Chairman and some non-voting observers). This governance may be a factor which makes it more difficult to take action in sensitive areas, particularly with respect to Article 17 enforcement action.

To remedy the mentioned deficiency, we would propose the following change to the composition of the "Management Board" and the "Board of Supervisors", which is based on the ECB governance structure:

- The **Management Board** composed only of independent and highly-qualified individuals, including the Chairman, appointed by qualified majority of the Council and a non-binding opinion of the European Parliament.
- The **Board of Supervisors** composed of the chairs of all the national competent authorities plus the members of the Management Board: the **chairman** of the Management Board should coincide with the Chairman of the Board of Supervisors (BoS).

Furthermore, members of the Board of Supervisors should be appointed in the first instance with mandates starting at different points in time in order to have de facto a staggered and more independent board.

Another aspect we feel could be improved is the current asymmetry due to the chairman not having the right to vote in the BoS whilst he has the right to vote in the management board. This should be corrected. The chairman should be allowed to have the right to vote in both bodies. In addition, the ESA Chairman ought to have a casting vote both in the Management Board and in the BoS[1].

[1] See EI response to CMU Green paper and response to "Call for Evidence on EU Regulatory Framework for Financial Services Action Plan".

We believe that such a framework would lead to a more effective ESAs' governance and may overcome the natural resistance of some of the National Competent Authorities to promote convergence in regulation and supervision.

b) Transparency and determination of tasks, priorities and competences of ESAs

The upcoming consultation could be a great opportunity to assess ESA`s tasks, priorities and competences. We believe that the work programmes of the ESAs should be focused on ensuring resource efficiency as well as effectiveness. Redundancies or overlapping competences on European and national level between ESAs and NCAs should be avoided. We would like to see more transparency in elaboration of the work programmes and the priorities and how they correspond with the budget. Finally, we would see merit in giving the power to the Parliament to authorize the work programme and priorities of ESAs.

c) Stakeholder engagement

Decisions should be based on the broadest possible input. We hence recommend greater industry involvement and adequate opportunity to comment on Level 2/Level 3. In this context, we appreciate that expert and stakeholder groups (SG) have been established in each ESA. However, e.g. ESMA stakeholder and consultative Working Groups should be improved with regards to transparency and the balance of representation and governance:

- no minutes of the meetings are provided;
- members are not allowed to share information with their companies or organisations;
- no members appointed representing associations (in case of EPTF there are members appointed in a personal capacity but also in a capacity of associations, even allowing to provide a substitute for different meetings);
- in case of a resignation of a member, no possibility to provide a replacement is provided and no new call for interest is being launched;
- balanced representation of stakeholders: while in recent years' investors and financial services consumers have become overrepresented on ESMA stakeholder and consultative WGs, there is often a lack of representation of non-financial companies. If at all, only one representative of SMEs is allowed, not however any representative of non-financial companies. Thus, EuropeanIssuers asks for securing at least one seat on stakeholder or expert groups for **2 representatives of non-financial companies** (including one for SMEs).

Effective stakeholder engagement is only possible, if there is provided transparency in the ESAs regulatory process. Whilst there has been progress with regard to transparency, we still see room for improvement. This includes in particular better transparency of the ESAs decision making process. Transparency would e.g. be enhanced by publishing agenda and minutes of the meetings of the Board of Supervisors.

d) Peer review

The "peer review" foreseen in Art. 30 is very important especially because it can be made public. Unfortunately, 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". This limitation is likely to affect negatively the name-shame implicit in the public disclosure of bad results.

At the same time, we would appreciate if ESAs were obliged to solicit comments by stakeholders when drafting EU peer reviews in order to have useful comments other than those coming from the reviewed authorities themselves. The ESMA Principles on stakeholder engagement in peer reviews[2] point into the right direction, but need to be strengthened and improved.

ESMA Principles leave too much discretion left to the NCAs regarding the participation of stakeholders to ESAs activities. It seems to us that the NCA can de facto veto the participation of stakeholders included in the last categories or 'mute' their voice, because the Board of Supervisors decides whether the intervention is needed; the NCA can always veto a stakeholder of category B; furthermore, the NCA prepare the list of stakeholders to be contacted; last, according to the ESMA Principles, the NCA should always be present whenever there are contact with a stakeholder.

3. Appropriate balance between Level 1 and Level 2:

It can be observed in many financial services dossiers that the amount of provisions in legislative proposals delegating issues on level 2 has been increased over the past years.

Legislative bodies of the EU however shall ensure that all crucial political issues of the respective dossier are tackled on level 1. The temptation of overcoming possible deadlocks in Level 1 negotiations by deferring discussions on some key contentious matters to Level 2 needs to be avoided. Thus, the delegation of power must be clear, precise and detailed and may only aim to supplement certain non-substantive elements of the legislative act.

4. Functioning of ESAs

Taking opportunity of the upcoming consultation, we wish to flag up certain issues with respect to the functioning of ESAs. An improvement in those areas would contribute to the efficiency of the supervisory authorities.

a) Better regulation agenda

The European Better Regulation Agenda aims at ensuring that European law-making procedures remain at the highest standard in terms of impact assessment, transparency, public consultation, and implementation. Laws should be finalized well before their application and stakeholders should have the time to prepare for the new rules. Improvement is specifically needed regarding the timeline for the adoption of Level II measures. Under the Market Abuse Regulation, the Level II measures apply from 3 July 2016, as the main Regulation (MAR). However, out of 16 level II measures: 7 have been published only in June (2 of them on 30th and 29th June); 6 in April; 2 in March; 1 in December. The

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[2] See https://www.esma.europa.eu/sites/default/files/library/2016-632_stakeholder_engagement_in_peer_reviews.pdf .

guidelines were published on 13 July, 10 days later. Therefore, companies did not have enough time to look at those measures and put in place the needed arrangements.

In addition, as MAR extends some disclosure requirements also to companies on MTF (i.e. which are essentially small and id-caps). Those companies did not have any experience nor structure in place to cope with those requirements. Moreover, the lighter regime foreseen for companies on the "SME Growth Market" is not yet applicable because of the postponement of MIFID II application, and, therefore, of the creation of those markets.

Given heavy obligations and serious consequences in case of non-compliance (including criminal sanctions) stemming from MAR provisions, the situation is particularly difficult. Thus, we think that the consultation should consider this kind of situations and possible solutions. Our recommendations for improvements are:

- when Level I foresees many Level II measures, the legislator should allow a longer transition period.
- a general provision in the ESMA regulation (or a specific provision at Level I) should state that Level II measures must be published at least 6 months before the date of application of Level I.
- a general provision in the ESMA regulation obliging ESMA to notify the Commission in case ESMA is not able to deliver certain measures on time. Subsequently, the Commission should take an appropriate action (for e.g. postponement of the date of application of level I).

b) Emergency situations

Regarding the action in possible emergency situations, a critical issue is the lack of possibility for an ESA to declare the existence of an emergency: the ESA may only "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).

The process is incompatible with the nature of an emergency situation which may require, for example, to decide on a Sunday night to suspend trading on certain classes of financial instruments or to limit short selling. Moreover, per the safeguard clauses (Art 38), the ESAs shall ensure that no decision adopted in the case of an emergency situation and settlement of disagreements impinges in any way on the fiscal responsibilities of Member States. The concept of 'fiscal responsibility', as it has been proposed, seems vague and potentially too extensive, thus it could generate controversies. Furthermore, in the case of ESMA, the typical decision in case of an emergency situation (such as we have mentioned above, suspension of trading and limitation of short selling) by definition would be excluded by Art 18.

5. Funding

EuropeanIssuers understands that the Commission envisages revising the current ESAs funding model, considering an increase pf the proportion of funding contributed by industry, also including non-financial companies.

EuropeanIssuers strongly opposes to change the current ESAs funding model for the following reasons:

a) The current model is the result of a sophisticated system, which balances contributions and control mechanisms between Member States and the European Union in an equal and fair manner. The current model most importantly empowers the European Parliament to exert budgetary control over the ESAs and thereby ensures that ESAs can be held accountable. It guarantees democratic control which would otherwise be largely missing. Any alteration would thus threaten the already relatively low level of democratic legitimacy of the ESAs.

b) A prerequisite for considering any change to the funding model would be to improve the supervisory governance and overcome the above-cited shortcomings. The existing system of multi-level regulation and supervision, which involves the participation of both Member states' supervisory authorities and ESAs in a single governance structure which would ensure cooperation and consistent supervisory approaches between the ESAs, has revealed its limitations and a new framework is needed to promote better convergence in regulation and supervision. If these deficiencies are not remedied there is no justification to change the existing funding model.

c) Last, Non-financial companies are primarily affected by ESAs` activities when it comes to regulatory measures on purely issuers` related matters. Those measures only form a minor part of the ESAs` activities and expenditure and therefore can`t be compared with those for e.g. the supervision of banks of systemic risk. Consequently, it doesn't seem to be proportionate to burden the funding obligation on non-financial companies.

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***EuropeanIssuers** is a pan-European organisation representing the interests of publicly quoted companies across Europe to the EU Institutions. As at 31 December 2014, there were 13 225 such companies on both the main regulated markets and the alternative exchange-regulated markets. Our members include both national associations and companies from all sectors in 14 European countries, covering markets worth € 7.6 trillion market capitalisation with approximately 8000 companies.*

We aim to ensure that EU policy creates an environment in which companies can raise capital through the public markets and can deliver growth over the longer-term. We seek capital markets that serve the interests of their end users, including issuers.

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ANNEX: Examples of ESMA overstepping its mandate

Example 1: ESMA technical regulatory standards on MiFID II

a) *Commission-based distribution services*

Regarding commission-based distribution services, the EU legislator's decision in the Level 1-MiFID II-text was to allow the co-existence of commission-based distribution alongside the independent advice based on adequate information about the nature of the distribution channel. Whether a ban on commission-based distribution services is introduced or not, should be ultimately left to the Member States. However, the list of negative criteria tabled by ESMA in order to assess the legitimacy of inducements would have, if applied to dealing commissions, led to an effective ban of the commission-based distribution services in Europe. This outcome clearly conflicted with the Level 1-text.

b) *Investment research*

ESMA qualified investment research provided to portfolio managers as inducements under MiFID, even though such treatment having major implications for the research market in Europe. Such push from the ESMA's side disregarded the intention of the EU institutions which had not address the question of research during the MiFID II legislative proceedings.

Given the relevance of the issue for the research coverage of European undertakings, especially in the SME sector, and for the quality of services by European portfolio managers, it should have been clear that the decision upon the regulatory approach to research required the involvement of the EU legislative bodies.

Example 2: Envisaged obligation to prepare consolidated financial statements under IFRS in the structured electronic format using XBRL/iXBRL under the Transparency Directive 2004/109/EU (TD)

According to Art. 4 para. 7 of the TD, issuers have to file their annual reports in an electronic format by 2020. ESMA envisages to develop draft Regulatory Technical Standards to specify this format. In a feedback statement following a consultation, ESMA has reached a conclusion that issuers should:

- *prepare Annual Financial Reports in the human readable XHTML (Extensible Hyper Text Mark-up Language);*
- *ensure that the information in the consolidated financial statements prepared under IFRS shall be marked-up using the XBRL (Extensible Business Reporting Language);*
- *embed the XBRL data directly into the XHTML documents through a format known as Inline XBRL (or iXBRL).*

However, the requirement of the TD is only to harmonize the electronic format, no specific format is therefore pre-determined by level 1. Thus, we believe that ESMA should rather consider other, less burdensome, kinds of electronic formats and leave room for flexibility, as foreseen by the TD. The outcome should thereby be based on the practice of the majority of Member States (requirement of

a filing of the annual financial reports in PDF). We understand that certain investors' surveys demonstrate that they do prefer reporting documents in PDF compared to other formats[3].

Example 3: Broad interpretation of Market Abuse Regulation (EU) No. 596/2014 (MAR) resulting in overly bureaucratic Level-2-Regultions

ESMA's interpretation of the Level I text of the Market Abuse Regulation ultimately resulted in Delegated Acts concerning the Market Abuse Regulation ESMA/2015/224 that are overly bureaucratic, increase compliance costs for listed companies and take an extremely wide interpretation that thwarts the political will of the level I text, whose intention was to avoid exactly this effect.

One example are the very detailed requirements for insider lists according to Delegated Regulation (EU) 2016/347). The lists have to include the private cell phone number of the people on the list as well as an national identification number. In the same vain and the obligation to record the concrete time of every insertion in the inside list appears to be superfluous having in mind that the objective of insider lists is to identify persons having access to inside information.

Another example is how ESMA interpreted the notion "transaction" in Art. 19 MAR. ESMA suggested to that also "passive" transactions have to be disclosed as managers' transactions which is clearly misleading the market and therefore misses the objective of the Art. 19 MAR. ESMA's interpretation resulted in Art. 10 of the Delegated Regulation (EU) 2016/522 which compiles a very long list of transactions that have to be notified. We have always argued that many of the transactions mentioned in the list do not have any signalling effect for the market, because they do not show whether the expectations of the relevant person discharging managerial responsibilities (PDMR) in the future development of the company have changed. A signal can only be derived from securities transactions, where PDMRs are active. In contrast, inheritances, gifts and donations of shares or financial instruments relating to shares under a pre-determined remuneration package have no signalling value but rather confuse the market.

Example 4: regulatory technical standards on prospectus related issues under Omnibus II

The regulatory technical standards on prospectus related issues under Omnibus II are contrary to the Prospectus Directive as regards to the so-called APMs. With respect to the accompanying advertising of public offers of securities, ESMA has breached the normative content of Art. 15 para. 4 Prospectus Directive. According to ESMA, so-called Alternative Performance Measures (e.g. the figure "Ebit") must not be mentioned, if they are not listed in the prospectus. This outcome can`t be derived from Art. 15 para. 4. The level 1-rule of Art. 15, para 4 Prospectus Directive only requires that information provided in advertisements is consistent, but not that the issuer is not allowed to give more information than contained in the prospectus. This might result in strange situations, where the issuer won't be allowed to answer questions of investors in personal 1o1s. If investors ask for figures not listed in the prospectus, for example the EBIT of 6 years ago, the issuer would not be allowed to provide information although it is consistent with the annual statements of 6 years ago.

[3] See the Financial Reporting Council's Financial Reporting Lab Project on Digital Reporting: https://frc.org.uk/Our-Work/Publications/FinancialReporting-Lab/Lab-Project-Report-Digital-Present.pdf