

Response to the Consultation on the review of the European System of Financial Supervision

The Institute gave this answer to the Consultation on the review of the European System of Financial Supervision by the European Commission in 2013. The research team for this consultation consists of Prof. Dr. Rüdiger Veil, Dr. Malte Wundenberg, Dr. Fabian Walla, Daniel Klingenbrunn, Marcus P. Lerch and Philipp Koch.

1. The European Supervisory Authorities (ESAs)

1.1. Effectiveness and efficiency of the ESAs in accomplishing their tasks

1.1.a. How do you assess the impact of the creation of the ESAs on the financial system in general and on (i) financial stability, (ii) the functioning of the internal market, (iii) the quality and consistency of supervision, and (iv) consumer and investor protection in particular?

This opinion refers to the creation of ESMA and its task to contribute to ensuring the coherent, efficient and effective application of the relevant EU law. The other ESAs are not considered here.

ESMA fulfills an important function within the European financial markets law. In general, ESMA has undertaken important steps in reaching the objectives set by the ESMA-Regulation. In particular, ESMA's guidelines and recommendations ensure a uniform application of EU law. But it is too early to evaluate whether the "watch-the-watchers-model" will work in the future. There might be good reasons for national authorities not to comply with recommendations.

One main issue for the future work of ESMA will be the protection of investors and consumers. From today's perspective, ESMA's understanding of investor and consumer protection remains unclear. This will have to be resolved for each regulatory area.

1.1.1. Work towards achieving a single rulebook - regulatory activities

1.1.1.a. Do you consider that the technical standards and guidelines/recommendations developed by the ESAs have contributed to further harmonise a core set of standards in the area of supervision (the single rulebook)? If you have identified shortcomings, please specify how these could be addressed.

ESMA's Aim of a Single Rulebook

ESMA's understanding of a "single rulebook" is not altogether clear. At best, ESMA's public statements with regard to achieving a single rulebook invite speculation as to whether the term is meant to describe simply a very tight net of harmonised rules. Furthermore, ESMA's understanding of the "single rulebook" mainly seems to be limited to ESMA's guidelines and recommendations and the technical/implementing regulatory standards endorsed by the Commission. It is quite understandable that ESMA focuses on these instruments since ESMA has limited competencies with regard to enacting binding law.

However, a "single rulebook" should be understood in a broader sense. The legislature on level 1 (framework directives and regulations) should also be taken into account when developing a single rulebook for financial markets. The four framework directives (Market Abuse Directive; Transparency Directive; Markets for Financial Instruments Directive; Prospectus Directive) must be seen from a historical point of view – each having been enacted as an answer to current issues, rather than as part of a consistent, overarching concept. The current reforms will leave the content of the four framework directives largely unchanged, although a systematic restructuring of the provisions, comparable to banking law, appears far more recommendable. Such restructuring in a truly single rulebook would render the regime more systematic and the different areas could be better adapted to each other.

We recommend that a Committee established by the Commission works on the long-term goal of a single rulebook. The Commission and ESMA should be represented on this Committee.

Harmonisation by Technical Standards and Guidelines/Recommendations

Principally, ESMA's Technical Standards and Guidelines/Recommendations contribute to a further harmonisation of financial markets law within the EU. On the one hand, these regulatory instruments reduce legal uncertainty. On the other hand, they increase the complexity of financial activities. This is, however, unavoidable. In order to give a reliable assessment of ESMA's work it is important to analyse each of the standards and guidelines.

- Guidelines on certain aspects of the MiFID suitability requirement (ESMA/2012/387)

The guidelines will (further) increase the complexity of investment services, such as investment advice and portfolio management. Remaining flexibility for market participants will mainly be limited to technical transposition measures.

The guidelines may be of indirect relevance in possible suits by private investors. However, the German Federal Court of Justice (BGH – Bundesgerichtshof) is rather skeptical when it comes to considering regulatory standards to determine alleged violations of duties under civil law. Frictions between regulatory standards and civil law duties may occur, as it should not be taken for granted that the courts will particularly aim at achieving consistency as between civil law duties and the relevant regulatory standards.

- Guidelines on certain aspects of the MiFID compliance function requirements (ES-MA/2012/388)

The guidelines are – even when compared to the principles of the Basle Committee of Banking Supervision – surprisingly specific and comprehensive. Many of the important aspects of a compliance organization are addressed in the guidelines. However, the guidelines give the market participants a great deal of flexibility. This is also due to the fact that the guidelines are based on a risk-based approach to compliance. Thus, it seems likely that the guidelines succeed in fostering a coherent application of the high-level MiFID rules.

The interplay of supervisory law and corporate law is only addressed occasionally. However, the guidelines have taken into account that some of the principles of compliance can contradict with general corporate law principles.

1.1.1.b. What is your assessment of the work undertaken by the ESAs as regards providing opinions (e.g. technical advice) to the EU institutions?

ESMA has issued only one opinion (ESMA/2011/342) so far. Therefore, it is not possible to assess the respective work by ESMA.

1.1.2. Common supervisory culture/convergence of supervisory practices

1.1.2.a. In your view, did the ESAs contribute to promoting a supervisory culture and convergence of supervisory practices? If you have identified shortcomings how could these be addressed?

ESMA has identified in its reports the problem that supervisory practices differ greatly all over Europe. For the future, more analyses should be undertaken by ESMA with regard to the intensity and efficiency of market surveillance by national regulators.

1.1.3. Consistent application of EU law

1.1.4. Emergency situations

1.1.5. Coordination function (Art 31 ESAs Regulations)

1.1.5.a. Do you think that the coordination role of the ESAs is appropriate? If you have identified shortcomings, please specify how these could be addressed.

Principally, the coordination role of ESMA (“watch-the-watchers-model”) is appropriate. However, this function poses the danger of overregulating. ESMA seems to be aware of this danger and has developed a three-fold system of coordination in its guidelines:

Generally, two different types of guidelines can be distinguished: (i) “must”-requirements which reflect EU provisions and (ii) “should”-requirements by ESMA. Most of the ESMA guidelines consist of “should” requirements. Furthermore, (iii) ESMA guidelines occasionally “describe” specific practices of the national supervisory authorities. In the view of ESMA this description of the specific practices of national authorities aims to provide the reader with additional information on differing approaches of national authorities without triggering the comply or explain-obligation under Art. 16 (3) ESMA-Regulation. Apparently, the described practices are regarded as “best practices” which may serve as a role model for other national authorities.

1.1.6. Tasks related to consumer protection and financial activities

1.1.6.a. How do you assess the role and achievements by the ESAs in the field of consumer protection? Please specify the main achievements by each ESA.

The ESMA guidelines specifically aim to strengthen investor/consumer protection. However, the terms “consumer protection” and “investor protection” are used interchangeably. The underlying concept of “consumer and investor protection” remains vague.

- Guidelines on certain aspects of the MiFID suitability requirement (ESMA/2012/387)

The guidelines mainly speak of “clients” and differentiate them according to their “professionalism”. Furthermore, they refer to “consumers” and “clients”. However, no precise clarification exists as to whether the terms investor, consumer and client are to be distinguished and if so, where the differences between those terms lie.

- Guidelines on certain aspects of the MiFID compliance function requirements (ESMA/2012/388)

Interestingly, one of the recommendations state that investment firms should promote and enhance a “compliance culture” throughout the firm. The purpose of the compliance culture is, inter alia, to “engage staff with the principle of improving investor protection”. Investor protection is understood, therefore, as a “mindset” of staff inside the firm.

It is also not specified how the principle of investor protection interacts with potentially conflicting principles, such as the duty of the staff to protect the interest of the company.

1.1.6.b. Are you aware of the warnings that were issued by the ESAs so far? If yes, please specify which ones and whether they have contributed to improve consumer protection or any other objective of the ESAs.

This instrument plays no relevant role. ESMA has issued three warning so far.

1.1.6.c. What are the main strengths and weaknesses of the current framework on consumer protection (Article 9 ESAs Regulations) and what would you suggest to address any possible shortcomings?

The strengths and weaknesses of the current framework on consumer protection depend mainly on the level 1- and level 2-legislature. These legal acts are currently under reform. Afterwards, ESMA should develop principles of investor protection. ESMA should try to answer the fundamental question, to which extent and by which means do not only investors, but also consumers have to be protected by financial markets law.

1.1.7. Direct supervisory powers

1.1.7.a. How do you assess ESMA’s direct supervisory powers? If you have identified shortcomings, please specify how these could be addressed.

As the work of credit rating agencies does have a consistent significant effect on all Member States’, financial markets supervision on a European level is justifiable. The most influential credit rating

agencies originate in a Non-EU nation. This also explains why Member States gave up sovereign rights to ESMA. Regarding the European Monetary Union and especially the effect of ratings on a Member States' ability to obtain credits on financial markets there may be a political will to influence the work of rating agencies via national regulators. By transferring the day-to-day supervision to ESMA, this influence becomes much less probable and a possible negative effect on the trust in the common currency can be prevented.

1.1.7.b. How do you assess ESMA's performance for the registration and supervision of credit rating agencies (CRAs)?

The central registration of credit rating agencies at ESMA is a major improvement in EU financial markets law. It especially solves the problems that stem from the former registration process, which had no single entry point. The registration procedure is accepted by the market. The maximum time frame of 60 days for a registration procedure is appropriate regarding the amount of information.

Principally, the two-fold sanctioning regime is appropriate. However, the regime on the European level could be improved. Sanctions against credit rating agencies diverge between 100.000 € and 750.000 €. It is doubtful whether these amounts of fines have deterrent effects for rating agencies whose profits are several billion USD a year. The Credit Rating Agency Regulation demands that the fine is at least the profit the credit rating agency extracted directly or indirectly from the breach, but it is unclear, how a "direct or indirect" connection between breach and profit can be established. The most deterrent sanction is – although it is not considered a sanction – the withdrawal of registration. Unfortunately, there are no clear rules when ESMA can withdraw the registration.

1.1.7.c. Do you consider that further responsibilities of direct supervision should be entrusted on one or more of the ESAs, particularly with regard to institutions or infrastructures of pan-European reach? Please explain.

Generally, the day-to-day supervision should be done by national authorities that have direct contact to market participants and access to information. Nonetheless, there may be areas of capital market regulation that could be supervised by a European authority, such as Central Clearing Parties (CCPs), that must register at the national authority. It is a political decision whether ESMA should get further powers and be entitled to directly supervise market participants.

1.2. Governance of the ESAs

1.2.1. General governance issues

1.2.1.a. Are the governance requirements sufficient to ensure impartiality, objectivity and autonomy of the ESAs?

The ESMA-Regulation demands independence of the Authority, its directors and its boards. They should be independent from political influence from the Member States and the European Union and from industry influence. It is difficult to evaluate whether the legal requirements have shortcomings. However, one aspect seems to be critical. The management board and the supervisory board consist of members of the national authorities. They will always have national interests in mind. But the ESMA-Regulation tries to mitigate possible conflicts and demands the members of the two boards to act independently and objectively in the sole interest of the EU.

1.2.2. Decision-making bodies and voting modalities

1.2.3. Financing and resources

1.2.4. Involvement and role of relevant stakeholders

1.2.4.a. How would you assess the impact of the relevant stakeholder groups within the ESAs on the overall work and achievements of the ESAs?

ESMA is still a very young authority. Therefore it is important that ESMA has established several Stakeholder Groups.

However, stakeholders are not sufficiently involved on the level 1-legislature. The public consultations conducted by the Commission are restricted to general questions of regulations. We recommend establishing a Committee of stakeholders dealing with the fundamental questions of capital market regulation. This Committee could also have the task to provide (legal) expertise in the course of level 1-legislature.

1.2.4.d. In your experience, does the composition of stakeholder groups ensure a sufficiently balanced representation of stakeholders in the relevant sectors? If not, which areas appear to be insufficiently/overly represented?

More legal expertise should be considered in the stakeholder groups (academics and attorneys).

1.2.5. Joint bodies of the ESAs