

Vice President Valdis Dombrovskis
Commissioner for Financial Stability,
Financial Services and Capital Markets Union
European Commission
Rue de la Loi, 200
1049 Brussels
Belgium

5 February 2018

Dear Vice-President Dombrovskis,

Response to the proposal for review of the European System of Financial Supervision

The International Regulatory Strategy Group (IRSG) is a practitioner-led body comprising leading UK-based figures from the financial and related professional services industry (FRPS). It is one of the main cross-sectoral groups in Europe for the FRPS industry to discuss and act upon regulatory developments.

Within an overall goal of sustainable economic growth, it seeks to identify opportunities for engagement with governments, regulators and European and international institutions to promote an international framework that will facilitate open and competitive capital markets globally. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing industry views.

TheCityUK and the City of London Corporation as co-sponsors of the IRSG welcome the proposal following the consultation by the European Commission ('the Commission') to review the European System of Financial Supervision (ESFS). After this unprecedented period of regulatory reform, we would first like to commend the ESFS for their work and achievements to date. The UK and the UK-based FRPS industry have both contributed to the development of, and been subject to, the ESFS since its formation in 2010, and are grateful for the opportunity to comment on the recent proposals. This is especially important as the IRSG is an international body which contributes to the discussions on global standards and makes use of our EU and international experience. The IRSG is well placed to contribute to this review given its previous work on these issues.

In our previous response to the Commission's review the IRSG highlighted the following four key areas of focus:

- 1) Improving coordination between the European Supervisory Authorities (ESAs), the Commission and National Competent Authorities (NCAs) including those of European neighbourhood partners
- 2) Promoting international regulatory coherence and convergence, where it is felt the ESAs play globally leading roles
- 3) Increasing interoperability between legislation to ensure minimisation of gaps, consistency and appropriate scheduling
- 4) Implementation of a streamlined system for data reporting

The table below outlines the key points and areas of focus in this response:

Theme	Key points
Enhanced powers for the ESAs	<ul style="list-style-type: none"> - Coordination between ESAs, the Commission and NCAs should be improved - There should be a staged approach to enhancing powers for ESMA - ESMA in its expanded role should create continuous dialogue with industry - Risk that expanding the remit of the ESAs will complicate the division of responsibilities of NCAs and European supervisors - With the increase of resources for ESAs there should be further focus on supervision and coordination
Better regulation and forward looking themes <ul style="list-style-type: none"> - Public consultations and stakeholder groups - Sustainable finance - FinTech and reporting requirements - Regulatory Forbearance 	<ul style="list-style-type: none"> - Better regulation principles should be applied in a way that can be measured - Long-term environmental, social and governance (ESG) risks need to be considered in the holistic risk analysis picture - Recommend a common supervisory culture for FinTech, building on the success of NCA's use of a 'regulatory sandbox technique'. - Reporting requirements at both national and international level should be more closely aligned - Welcome proposal to require ESAs to withdraw existing guidelines/recommendations upon advice from the Stakeholder Group acknowledging the legal difficulties, the ESAs would benefit from certain forbearance tools
Funding arrangements	<ul style="list-style-type: none"> - There needs to be further clarity on how changes in funding structures will operate and how these will affect costs to industry - Decisions on how ESAs' costs are covered by industry should be subject to a separate consultation - There should be a mechanism to ensure transparency and accountability of budgets - Budgets should be developed in line with clearly defined criteria and subject to external scrutiny
Third country regimes and international regulatory coherence	<ul style="list-style-type: none"> - Recommend strong and continuous engagement with third country regulators - There is a need for transparency in the decision making process - ESAs should be provided with the necessary resources to undertake these responsibilities - Further consideration to be given to the pivotal role of the ESAs in global standards - Enhance international regulatory coherence - Third Country NCAs should be able to review reports on their alignment with the EU framework before these are sent to the Commission.
Data	<ul style="list-style-type: none"> - Welcome the Commission's consultation on reporting - Produce specific guidelines on the format and application of particular reporting fields

We welcome the Commission's proposal which strives to accelerate the completion of the Capital Markets Union (CMU) and strengthen the pan-European approach to financial supervision. The IRSG supports many of the ideas underpinning the proposals. The implication of any changes in the transfer of powers to the ESAs should be considered on a case-by-case basis with a full cost-benefit analysis dedicated to each change in responsibility. It is important to note that capital market supervision is particularly complex and requires a differentiated approach to retail activity, for example.

The IRSG believes that any reforms to the ESAs should be driven by the ambition to complete the CMU in a timely manner, building on international regulatory standards and adhering to better regulation principles. The ESAs review should be guided by the following principles:

- 1) The global competitiveness of the EU's financial sector should be maintained
- 2) Financial stability, market integrity and consumer protection should be at the heart of the ESAs work
- 3) ESAs should seek to maximise the benefits from innovation and new technology
- 4) Non-legislative and market based solutions should be used wherever possible
- 5) Openness to investment and capital from outside the EU and cooperation with third country regulators should be enhanced
- 6) The ESAs should be enhanced in terms of transparency, accountability and resources.

Enhanced powers for the ESAs

As highlighted above, we stressed the need to improve coordination between the ESAs, the Commission and NCAs in our previous response.

The current proposal suggests that, rather than further coordination between the above institutions, many powers are removed from NCAs and given to the European Securities and Markets Authority (ESMA) in particular. We support the overarching longer-term vision for the ESAs to play an increasingly prominent role in creating a level playing field as proposed in the paper. However, the IRSG is concerned that they, and ESMA in particular, needs fundamental enhancements to its capabilities, transparency and accountability if it is effectively to deliver on an expanded mandate in the future.

The IRSG does not support the transferring of certain prospectus approvals to ESMA. We believe that NCAs deal with the supervision of prospectuses sufficiently and we are concerned that the proposals could hinder market efficiency. Prospectuses are best reviewed and approved by NCAs who have the expertise of the local market and understanding local risks and developments e.g. through other supervision activities/local policy changes.

We would encourage all ESAs, in their expanded role, to create a culture of continuous dialogue with the industry to allow us to work together to achieve regulatory goals in the most effective and least disruptive way for the market. In particular there is an opportunity for further engagement in the Level 3 process. We encourage ESAs to spend more time engaging actively with market participants to keep on top of market developments.

Elsewhere, there is a risk that the proposals to expand the remit of the ESAs will complicate division of responsibilities between national and European supervisors. For example, the European Insurance and Occupational Pensions Authority's (EIOPA) new power to issue non-binding opinions on internal models could confuse the relationship between EIOPA and NCAs, leading to inconsistency and uncertainty for industry.

As suggested by the Commission, an increase in resources designated to the ESAs will enable further work with the NCAs to ensure alignment and enhanced consultation on the issues. The increased resources for the ESAs along with the move away from a mostly rule-making role will enable an increased focus on coordination and other activities. This will allow the ESAs to remain at the forefront of regulatory development and support markets to operate effectively.

In conclusion, enhanced powers for the ESAs at this point in time should be pursued as part of a staged approach. As a first step, and with the increase of resources for the ESAs, further coordination of the work of the NCAs, rather than directly transferring powers would ensure increasingly aligned processes across Member States.

Better regulation and forward-looking themes

The IRSG and its members are committed to high standards of governance and better regulation principles. We welcome the expansion of the Better Regulation Principles to the ESAs and request that these are applied in such a way so that they can be measured in the ESAs working practices.

Public consultations on guidelines and stakeholder groups

We welcome the Commission's proposal to require the ESAs to conduct public consultations, but believe a more consultative approach should apply to Q&As. Q&As are considered to be Level 3 instruments that provide important clarifications and/or interpretations on implementation matters. The Q&A process should therefore be made more transparent so that industry can have sight of the questions that are under consideration by the ESAs and allow for a short consultation process.

We welcome the Commission's proposal to allow the Commission to require the ESAs to withdraw existing guidelines/recommendations when the Stakeholder Group has issued an opinion where two thirds of their members consider that the ESA has exceeded its competence. However, the IRSG believes there is a risk that the proposed threshold of two thirds may be too high and lowering this could be considered. Additionally, we think the proposal should apply to Q&As.

Increased transparency on how ESAs approach stakeholder feedback and strengthening the role of stakeholder groups would also be welcome as the consultation with market participants, professional users of markets and consumers is the foundation of effective rulemaking.

Sustainable finance

We fully support the Commission's requirement that ESAs integrate environmental, social and governance (ESG) risks into their work. We recognise the impact these risks may have on financial stability and that factoring these into the work of ESAs can help ensure that financial services activity is more consistent with sustainability objectives.

Long-term ESG risks such as resource depletion, climate change and social change need to be considered in the holistic risk analysis picture. By managing ESG risks more closely we believe this

initiative will lead to a more ethical, sustainable market with increased trust from businesses and consumers alike. This will lead to greater understanding of the key issues affecting the European market. The responsibilities of the ESAs should work in tandem with other policy priorities.

FinTech and reporting requirements

The IRSG and its members are committed to improving regulation and the need to keep pace with new market developments, including the Commission's proposed promotion of sustainable finance and prioritising FinTech.

Many industry stakeholders have identified a need for a common supervisory culture in regards to FinTech. FinTech and cyber security are key priorities for the industry and any proposals to ensure the ESAs oversee a more coordinated approach by NCAs to these issues will be welcome.

Regulatory gaps or inconsistencies faced by NCAs across Europe could be significantly minimised by a more coordinated approach at an ESA level. In our response in June we highlighted the need for consistency in definitions of core terminology for complex products; this is particularly important in cyber and FinTech. A lack of clear industrywide standards for FinTech and cybersecurity will result in inconsistent data sets.

The IRSG recommends that reporting requirements at both national and international level be more closely aligned in order to assure accuracy and consistency. Some firms, especially those offering complex products, struggle with reporting requirements due to inconsistency in definition of core terminology across EU legislation. For example, the Level 1 text of the Central Securities Depositories Regulation does not provide for adequate definitions leading to concerns about the entities affected, the instruments covered and the territorial reach of the Regulation. This can then lead to difficulties for ESMA in drafting level 2 text. In financial legislation, definitions are important tools to ensure implementation requirements are well understood and adhered to.

The IRSG believes there should be more effective data usage within the ESAs' operations. In particular there should be specific guidelines to determine the explicit format and application of particular reporting fields.

Regulatory forbearance

In order for markets to operate efficiently and effectively, the ESAs would benefit from certain forbearance tools. The IRSG has previously discussed these issues in its report 'The cumulative impact of EU financial services regulation: better regulation for jobs and growth'¹.

The IRSG believes that there is a need for a tool by which urgent and critical action can be taken when any of the following circumstances arise:

- Legislative timetabling issues
- Specific situations with individual legislative acts
- Issues restricted to local markets

¹ IRSG, 'The cumulative impact of EU financial services regulation: better regulation for jobs and growth' June 2016, available at <https://www.irsg.co.uk/assets/IRSG-report-The-cumulative-impact-of-EU-financial-services-regulation.pdf>

Notwithstanding the legal difficulties associated with the introduction of US style no action letters, consideration should be given to how these issues could be addressed.

Funding arrangements

We have studied the Commission's proposal to amend the funding structure of the ESAs. Currently a large amount of funding comes from NCAs. The removal of the NCAs from the funding structure will allow a more streamlined process. However, it is not entirely clear how the changes in the funding structure will operate and to what extent these will increase costs for industry. If this proposal is put in place the ESAs must be clear about the benefits that can be drawn. Changing the funding structure will have a bearing on the ESAs' wider responsibilities. It is important that there is a mechanism to ensure sufficient transparency. Any further decisions about how the ESAs' costs are recovered from the industry should be subject to a separate consultation. The ESAs will also need to be held accountable for budgeting decisions.

Where certain responsibilities are moved from NCAs to the ESAs, so should the resources. In this respect the IRSG believes that NCAs should not continue to charge the same fees if their remit has been reduced. Similarly, budgets should be developed in line with clearly defined and transparent criteria, and be subject to external scrutiny to ensure that any claim on the industry is necessary, proportionate and in line with the principles of better regulation.

Third country regimes and international regulatory coherence

We support the proposal for the ESAs to assist the Commission in making decisions on whether third countries are equivalent, which should be achieved by establishing strong and continuous engagement with third country regulators in accordance with the principles of regulatory deference and outcomes-based substituted compliance. We would like to stress the need for transparency in the decision making process, both in regards to initial decisions and continued monitoring of equivalence. Given the reliance by the ESAs on NCAs in assessing third countries currently, it is important that the ESAs are provided with the necessary resources to undertake this task. Similarly, the ESAs will require sufficient resource for the new responsibility of ongoing monitoring of the regulatory and supervisory and enforcement practices in third countries. Third Country NCAs ought to be able to review these assessments before they are sent to the Commission.

In the current proposal, global standards are only referenced in relation to tax, good governance and anti-money laundering. The IRSG would like the Commission to further consider how the ESAs' decision making is kept consistent with global standard-setting exercises to promote and shape regulatory coherence and the consistent implementation of global standards. The expertise that the ESAs provide whether directly represented or not is crucial to ensure markets continue to operate effectively. The IRSG believes that this can only be achieved by ensuring that operations at a national level have strong synergy with those at supranational level, such as the work of the Financial Stability Board (FSB).

More generally enhancing regulatory coherence and consistency to avoid market fragmentation should be a top priority. It is important to maintain or improve the channels for international regulatory coherence and coordination that currently exist as far as possible. Regulatory divergence

could impede the increasing international nexus of markets, creating barriers to Europe's competitiveness.

Data

Along with the key areas outlined in the Commission's proposal, we would also like to draw your attention to the issue of data which is high on the IRSG's agenda.

The proposal acknowledges the need for improved data collation and reporting. The IRSG, in its previous response, highlighted a lack of clear industry-wide standards which results in inconsistent data sets. The IRSG proposed that the ESAs could produce specific guidelines to determine the explicit format and application of particular reporting fields, so we welcome any changes to improve data collation and reporting.

We welcome the Commission's consultation on supervisory reporting in order to streamline and align the reporting obligations as far as possible and gain the resultant efficiencies anticipated by the co-legislators as soon as possible. Minimising duality and duplication in reporting would bring huge operational benefits.

The IRSG fully supports this consultation into the operation of the European System of Financial Supervision and would welcome the opportunity to discuss any of these themes in greater detail or provide further information in writing.

Yours sincerely



Mark Hoban
Chairman, IRSG