

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

Response by Finance Watch

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Finance Watch is an independent, non-profit public interest association dedicated to making finance work for society. Its members represent, collectively, many millions of European citizens and include consumer groups, trade unions, housing associations, financial experts, foundations, think tanks, environmental and other NGOs.

Finance Watch was founded on the following principles: finance is essential for society and should serve the economy, capital should be brought to productive use, the transfer of credit risk to society is unacceptable, and markets should be fair and transparent.

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Finance Watch authorizes the publication of this consultation response.

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General Remark

Finance Watch is responding to this consultation based on general experience and information received from our Members who participate in stakeholder working groups or have contact with ESAs in other capacities. Our comments relate to the functioning of all three supervisory authorities (EBA, ESMA and EIOPA).

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?

ESAs have a wide range of tasks to fulfil however their actual powers vary considerably from task to task. In many fields, the tasks are limited to soft law instruments and are thus non-binding. In other fields, ESAs are competent to take decisions that are binding upon national supervisory authorities and individual financial institutions, although these decisions can be challenged

During the 2.5 years since the creation of the ESAs there have been some positive findings and some drawbacks. Most of the ESAs activities have been dictated by crises when markets were pressing for coordinated actions and national responses were not enough.

In the future we see an increased role of ESAs in the fields of supervisory convergence, risk identification and consumer protection. To fulfil these, they need additional resources and better governance arrangements

1.1.b. Do ESAs mandates cover all necessary tasks and powers to contribute to the stability and effectiveness of the financial system? Are there elements which should be added or removed from the mandate?

ESAs benefit from a degree of autonomy, legal personalities and permanent mandates, which should help them to contribute to the stability and effectiveness of the European financial system.

The ESAs' mandates allow them to contribute to the establishment of high-quality common regulatory and supervisory standards and practices; to contribute to the consistent application of legally binding Union acts; prevent regulatory arbitrage, mediate and settle disagreements between (national) competent authorities; ensure effective and consistent supervision of financial institutions; ensure a coherent functioning of colleges of supervisors and take actions, inter alia, in emergency situations¹. Additionally, the ESAs monitor and assess market developments, undertake economic analyses of

¹ Art 8(1) ESAs Regulations

markets to inform the discharge of the Authority's functions. Furthermore, they contribute to the consistent and coherent functioning of colleges of supervisors, conduct consumer protection tasks, and closely cooperate with the ESRB.² To achieve those tasks ESAs can draft legally binding regulatory and implementing technical standards. Additionally, although the ESAs are not configured to conduct daily supervision, they are tasked with some supervisory functions. They monitor market developments of the market segment they supervise (e.g. the European Banking Authority monitors the banking sector).³ In addition, they monitor systemic risk.⁴

In our view, the breadth and lack of precision in ESA mandates risks undermining their effectiveness and making it difficult to assess their transparency and accountability. The reason for this is that the broader the activity that is entrusted to an agency, the more difficult it is to identify specific goals and standards and the more unclear accountability becomes. The general nature of many of their objectives could hinder the transparency of policy choices and performance accountability.

Additionally, ESAs lack political back-up, which could result in resistance to their actions at some levels.

Also, imprecision and overlap between the mandates of ESAs (especially EBA) with those of the ESRB and ECB/SSM could undermine their effectiveness and lead to confusion about where responsibility ultimately lies, for example, when several agencies share the objective of ensuring financial stability.

1.1.c. In your view, do ESA face obstacles in meeting their mandates? If yes do you consider it to be the main obstacle?

In our view ESAs face several obstacles in meeting their mandates:

- **Legal:** The lack of reference to ESAs in the EU Treaties limits their legal ability to act. The Meroni doctrine of the Court of Justice of the EU strictly limits the delegation of powers to this type of body.⁵ The regulatory powers conferred upon Community agencies must not involve a “discretionary power, implying a wide margin of discretion which may according to the use which is made of it, make possible the execution of actual economic policy”.⁶ In the Romano ruling the Court added that the delegation of legislative powers was also precluded, especially of taking own policy choices.⁷

² Art 8-9 ESAs Regulations

³ Recital 9 of EBA and ESMA Regulations, and Recital 8 of EIOPA Regulation

⁴ Article 32(1) of ESA Regulations, op. cit. footnotes 102-104

⁵ Communication of the European Commission: European Agencies – The way forward; COM(2008)323 p. 2

⁶ Judgment of the Court of 13 June 1958. – Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community. – Case 9–56.

⁷ Judgment of the Court (First Chamber) of 14 May 1981. – Giuseppe Romano v Institut national d'assurance maladie-invalidité – Case 98/80

Agencies are non-treaty bodies therefore the national-level authorities are still primarily in charge of implementing EU law. This decentralised structure could lead to weaknesses in implementation.

- **Operational:** the funding model of ESAs (partially funded by NSAs) constrains the objectives set out in the mandate. External budget and staff constraints are transferring decisions on policy priorities to the Commission from the ESAs in a non-transparent manner, which is inconsistent with the original mandates given to the institutions. **To remedy this problem, ESAs need to be given significantly greater responsibility for managing their own resources and budgets, with appropriate accountability required by the management of the ESAs.**⁸
- **Political:** Micro-prudential supervision is conducted on the national level where the backstop is also located. During the last crisis, the lack of a common burden-sharing mechanism caused many Member States to favour solutions that maximised their national interest. The ESAs were not able to operate with full independence from political influence and could not reverse the trend of favouring national solutions. Setting up the Single Supervisory Mechanism (SSM) shifts the balance of tasks and powers between NSAs and the ECB. **The governance structure and decision making of EBA will become more complicated, as decisions will be made by double majority**, which could increase the effort needed to achieve a consensus based on national interests.
- **Data collection:** ESAs' abilities to collect information for their supervisory tasks is constrained by regulation. ESAs must first take into account information available at the EU level, before requesting data from national supervisors and subsequently from the Member States' other public bodies. An ESA is only allowed to request data from individual financial institutions if none of these other sources provides the required information. **This limitation calls into question their ability to accomplish tasks related to financial stability surveillance and to respond to emergency situations.**

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.

Finance Watch supports the development of a harmonized set of rules that will unify financial regulation across EU but not at the expense of quality. We believe that the single rulebook can benefit the financial sector by cutting regulatory arbitrage and gold plating but only if it holds EU financial system to higher, more rigorous standards.

⁸ IMF Technical note: Accountability and transparency of ESAs

If policymakers compromise on regulatory standards in order to achieve consensus for the single rulebook, they may find it harder to resist gold plating in future. **The long-term development of the single market therefore requires high regulatory standards that make implementation of additional national measures unnecessary.**

A strong single rulebook needs robust Level 1 legislation and the engagement of all stakeholders in the consultation process.

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?

The decision to create a Banking Union has given EBAs a special role in supervisory convergence by developing a single supervisory handbook to enhance supervisory coherence for the whole EU.

The ESAs have set the strategic direction by promoting best practice in supervision. By avoiding lax, selective and superficial supervisory practices, this approach will eventually help to build confidence in the financial system.

Finance Watch believes that the role of the ESAs in promoting common supervisory culture and practices should be developed and enhanced. So far this role has been secondary to developing regulatory responses and creating the single rulebook. **Hence in the future the ESAs should promote even more convergence of supervisory practices by developing instruments and convergence tools.**⁹ Regulations give ESAs the task of advancing supervisory cooperation and convergence, namely by facilitating the exchange of information between supervisors,¹⁰ peer review of supervisory practices¹¹ and mediation¹² between national authorities. The ESAs facilitate and stimulate the exchange of information and delegation of tasks between national supervisory authorities (NSAs), however through the process of binding mediation ESAs may alter supervisory obligations between NSAs. Therefore it has to be clear that accountability and responsibility for any actions undertaken go together.

⁹ Article 29.2 ESAs Regulation

¹⁰ Article 30

¹¹ Idem

¹² Article 17

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.

We strongly support that ESAs have competence in consumer protection and product supervision.¹³

We believe that the issue of consumer protection should be at the centre of ESA work in the upcoming years and should be developed under a harmonized approach.

While ESAs still lack expertise and capacity in this field we can indicate several positive outcomes: guidelines promoting certain practices in the MS, reports summarizing consumer trends, consumer protection day, and warnings addressed to the consumers.

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

We are aware of warnings on ESA websites (ESMA-news for investors, EBA- consumer corner, EIOPA- consumer protection and financial innovation) and support this type of engagement. **However, in our opinion the warnings are not visible enough to the general public.**

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 Board of Supervisors (the main decision making body of ESAs) and the Management Board are composed of members of national authorities.

Although members of the Board of Supervisors are required to act independently and objectively in the interests of the EU and are banned from taking instructions from any government, authority, organization or external body,¹⁴ **the fact remains that the representatives of the 28 NSAs are often bound by a national mandate and tend to act more in relation to their national interests rather than European interests.**

Finance Watch believes that the governance arrangements for the ESAs should be reviewed, with the aim of strengthening their operational independence and effective accountability.

¹³ Article 9

¹⁴ Article 42

1.2.1.b. How do you assess the accountability requirements? If you have identified shortcomings, please specify how these could be addressed

The Communication of the Commission noted that the lack of standardized rules applicable to agencies “make[s] the system untransparent, and raise[s] doubts about their accountability and legitimacy. The diverse role of agencies fuels concerns that they might stray into areas more properly the domain of the policy-making branches of the EU. The responsibilities of the other institutions toward agencies, and of the Commission in particular, suffer from the lack of a clear framework and defined lines of responsibility.”¹⁵

The fact that ESAs are placed within a democratic system does not guarantee sufficient mechanisms of accountability: while, technically, ESAs are accountable to the European Parliament and Council,¹⁶ their main channel of accountability is to the European Commission.

ESAs decision making process is often inaccessible to the public, despite many features designed to make it transparent and open to participation, and the public lacks tools to assess adequately the quality of regulatory policies and outcomes. Formal decisions taken by members of the Board of Supervisors illustrate the problem, as the Board is not held accountable at EU level for decisions taken.

Transparency and regular contacts with democratically elected bodies are preconditions for the effective accountability of an agency. However, they cannot substitute for remedies once it has been determined that the agency is not performing sufficiently or in case of an abuse of power. **In our view, enhanced democratic control and accountability could come in the form of the appointment and dismissal procedures of the head of ESAs by the Parliament.** Parliamentary approval enhances the democratic legitimacy of appointments and dismissals of agency officials.

Democratic legitimacy and accountability is not only an issue of legally binding rules but also an issue of perception. As a good example of increasing transparency and accountability we would highlight the FDIC Open Government initiative, which requires a federal agency to create a plan describing how it will implement the principles of transparency, participation, and collaboration in its activities.¹⁷

¹⁵ Communication of the European Commission; COM(2008)323 (European Agencies-The way forward)

¹⁶ Article 3

¹⁷ <http://www.fdic.gov/open/govplan82012.pdf>

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?

As financial rules affect a vast array of stakeholders, the development of binding standards should be based on clear and transparent principles, especially having in mind the lack of public and post-legislative control. Stakeholder groups have an advisory role in relation to Commission and ESA regulatory activities and enhance the legitimacy of ESA operations.

We believe that better transparency and involvement of stakeholders during the actions undertaken by ESAs would have a positive effect on the validation of the technical expertise for the regulation. **However, the biggest limitation of stakeholder groups is that their input has no legal consequence; their role is purely advisory and their advice non-binding.** The ESAs, after receiving the input of stakeholder groups, may, in some cases, decide to dismiss the content of their advice without facing any statutory liability for doing so. This compares poorly with the regime in jurisdictions such as the US, where agencies are required to explain why the opinion of stakeholders is or is not taken into consideration during the regulatory procedure and where stakeholders may challenge in Court the decisions of agencies on the grounds of lack of motivation for the regulatory decision.

Additionally, ESAs are not obliged to consult with the stakeholder group “if actions must be taken urgently and consultation becomes impossible, the [stakeholder groups] shall be informed as soon as possible.”¹⁸ This allows stakeholder groups to be side-lined from decision-making in some circumstances.

Finance Watch believes that stimulating public debate would help ESAs to integrate stakeholder views in public regulations. **Encouraging the press and public to follow the ESAs’ work, as happens with some high-profile US agencies, would strengthen ESAs’ legitimacy** as the public come to see their preferences reflected in ESA policies and see that decisions are taken on their behalf.

1.2.4.b. Are you satisfied with the quality and timeliness of consultations carried out by the ESAs?

Finance Watch believes that public engagement in consultations enhances their effectiveness and improves the quality of decisions.

However, respondents need sufficient time to prepare their analyses, which is resource intensive. As ESAs consult on very technical issues in very short timeframes, this could effectively limit participation to the financial industry.

¹⁸ Article 37.1 ESAs Regulations.

Current practice shows that a lot of controversial rules are being handled by ESAs within Level 2 (CRDIV/CRR, BRRD, MiFID). Insufficient consultation times could jeopardize the quality of these and other implementing rules.

Longer consultation periods would help to mitigate this risk. It would also be worth considering structural or official funding measures to ease the resource constraints that prevent non-industry respondents from engaging more fully in ESA consultations.

1.2.4.c. Are you satisfied with the appointment procedures for the stakeholder groups?

The conditions for appointment to stakeholder groups may limit the ability of some civil society representatives to apply or be selected for a stakeholder group, especially the requirement for a minimum of four years' relevant professional experience in the financial services sector for all Group membership categories.

According to the procedures, the professional experience and expertise ("professional quality") of candidates will be assessed against the category selected by the candidate in the application form. However, experience beyond the minimum criteria will be highly valued and, in most cases, necessary.¹⁹

Finance Watch considers the value of stakeholder groups to be their ability to balance different and sometimes competing interests in a fair and proportional way. The ability of stakeholder group members to advise on technical matters supports this objective but should be secondary to it. For this reason, **the selection procedures should focus more on the legitimacy of a representative to speak for a given constituency and their freedom from conflicts of interest, and less on their background in the financial sector.**

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?

A balanced representation of stakeholder groups is crucial in developing financial rules. When stakeholder groups are adequately composed it is also easier for society to accept certain solutions. The ESAs regulation states that stakeholder groups are composed of representatives from different forums with interests in financial regulation, however **in our opinion the number of civil society participants is not balanced in relation to financial market participants.**

Stakeholder groups "shall be composed of 30 members, representing in balanced proportions financial market participants operating in the Union, their employees'

¹⁹ ESMA Stakeholder Group Renewal Procedure 2013
3 Article 37.2. of ESAs Regulation

representatives as well as consumers, users of financial services and representatives of SMEs. At least five of its members shall be independent top-ranking academics. Ten of its members shall represent financial market participants.”²⁰ The ESAs Regulations therefore aim for a balanced representation but in practice they may be considered as asymmetrical.

The composition of stakeholder groups should also aim to minimise the effects of intellectual capture and conflicts of interest. Capture would include biases arising from the close relationships between regulators and regulated and between representatives of consumers and financial sector employees and the financial industry.

Non-industry stakeholder participants in expert groups report that official funding levels are inadequate to act as a proper counterweight to industry stakeholders. As an example, some ESA stakeholder groups reimburse travel expenses to non-industry stakeholders and pay a *per diem* for each meeting attended plus one day to prepare. In practice, this may not be enough and does not compensate for the fact that industry stakeholders come to meetings much better prepared as they are able to use internal resources to prepare their position or even contract external research (even though they are formally not supposed to do so and are expected to sit on the stakeholder groups as private individuals). **The level of direct funding for non-industry stakeholders should be reviewed and could be supplemented with an appropriate secretarial support.**

1.2.4.e. Is the work undertaken by the stakeholder groups sufficiently transparent? Do you see areas where the approach towards transparency needs to be revisited?

The transparency of stakeholder groups could be improved. We would like to stress the importance of an open and transparent process, ensuring that at multiple stages of the process there are **opportunities for broader public participation and scrutiny**, and that the economic impacts are more fully integrated into the process before a final decision is made.