



ADVICE TO ESMA

Position Paper on Supervisory Convergence

I. Executive summary

The objective of this paper is to provide advice to ESMA on supervisory convergence as one of the key strategies to be pursued by ESMA from 2016 until 2020. The SMSG also clarifies which role the group may play in supporting ESMA in its task to ensure consistent supervisory practices across the European Union.

II. Background

1. Supervisory Convergence as a Central Task of ESMA

1. One of the main tasks of ESMA is promoting supervisory convergence across the European Union (EU) with the aim of establishing a common supervisory culture (cf. Recital 40 and Art. 1 (1) ESMA Regulation No 1095/2010). Since its foundation in 2011, ESMA has pursued this task mainly by issuing guidelines and recommendations and through organising and conducting peer reviews of selected activities of national competent authorities (NCAs), such as enforcement of accounting principles and of financial information, market abuse and supervisory practices under MAD, MiFID suitability requirements, money market funds, practices on MiFID investor protection and on short selling. However, the work on supervisory convergence has been more limited in the last years due to ESMA's more urgent task to work on the "single rulebook", drafting regulatory and implementing technical standards (RTS/ITS), providing technical advice to the European Commission (COM) regarding delegated acts and issuing guidelines and recommendations required by the level 1-acts.
2. In its Strategic Orientation 2016-2020 (ESMA/2015/935), ESMA declared its intention to focus more of its resources on supervisory convergence work, clarifying its aims and target specific areas for increased supervisory convergence. This policy reflects the COM's recommendations in its report on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (COM(2014) 509 final).
3. On 11 February 2016, ESMA published the Supervisory Convergence Work Programme 2016 (SCWP 2016) (ESMA/2016/203). ESMA highlighted a number of supervisory convergence priorities for 2016 and explained its activities in each respective area. Additionally, ESMA described its preparatory tools, implementation tools and assessment tools. It follows from the SCWP that ESMA in the future will place greater focus on how NCAs supervise markets and enforce respective rules. To this end, ESMA will develop new supervisory convergence tools. This also includes the engagement of stakeholders in peer reviews (cf. ESMA, Principles: Stakeholder engagement in peer reviews, 15 April 2016, ESMA/2016/632).

2. The role of the SMSG

4. The Securities and Markets Stakeholder Group (SMSG) helps facilitate consultation with stakeholders in areas relevant to the tasks of ESMA. The SMSG may submit opinions and advice to ESMA on any issue related to ESMA's tasks with a particular focus on „common supervisory culture“, „peer reviews of competent authorities“ and „assessment of market developments“ (Art. 37 (5) ESMA Regulation No 1095/2010).
5. In the past, the SMSG has tackled this task to provide input on convergence of supervisory practices mainly at its regular meetings with ESMA. The focus of SMSGs' advice has been on questions relating to the effective application of European rules, but also issues of enforcement have been subject of discussion with ESMA. On the one hand, members of the SMSG have introduced selected topics on their own initiative and exchanged views with the ESMA chair, the ESMA executive director and ESMA staff. On the other hand, the SMSG has used the opportunity to comment on results of ESMA's peer reviews as presented by ESMA at the meetings in Paris.

3. Purpose of this Advice

6. The SMSG wishes to use the opportunity of the publication of ESMA's SCWP and ESMA's principles about stakeholder engagement in peer reviews to provide a high-level advice to ESMA on the parameters of ESMA's work on supervisory convergence.
7. The focus of this position paper is on the tools and instruments which ESMA may use for fostering consistency within the network of financial supervisors and developing high-quality and uniform supervisory standards. In particular, the position paper looks at ways how ESMA may, to a greater extent, benefit from the experiences of stakeholders. In this context, the role of the SMSG will be discussed.

III. Methodology of supervisory convergence

1. Tools and instruments

8. ESMA Regulation 1095/2010 provides a number of activities which ESMA shall carry out in order to pursue its goal to promote common supervisory approaches and practices in the EU. These include guidelines and recommendations, peer reviews of activities of NCAs, exchange of information and experiences as well as training programmes.
9. The SMSG considers guidelines and recommendations (Art. 16 ESMA Regulation No 1095/2010) to be an important instrument in ensuring a uniform application of the Union law. Though these are legally non-binding, NCAs have to make every effort to comply with guidelines and recommendations. Therefore, guidelines and recommendations are most suitable instruments in establishing consistent, efficient and effective supervisory practices.
10. A disadvantage of these instruments is that they increase the complexity of the regimes for financial markets. It is not desirable to clarify every technical aspect by way of guidelines. This is why ESMA also makes use of Questions & Answers (Q&A) as a more informal (less binding) and practical (neither public consultation of stakeholders nor consultation of the SMSG is required by ESMA Regulation No 1095/2010) instrument. The SMSG has on a number of occasions already welcomed the publication of Q&As. Q&As are not only aimed at NCAs but also at market participants who can use the Q&As as a valuable tool to gain a better idea of the proper implementation of financial markets law. A very

good example for valuable guidance is ESMA's Question & Answers Prospectuses, 23rd updated version, December 2015.

11. Q&As provide answers to questions not only raised by NCAs but also by market participants. To take better advantage of this tool, ESMA could establish a Q&A mechanism for the most relevant regulatory issues on its website which allows market participants to easily contact ESMA. This would also allow ESMA to get institutionalised feedback from stakeholders. Moreover, ESMA could consider to inform the SMSG when it adopts or amends Q&As (though it is not required to do so according to the ESMA Regulation 1095/2010). It might be of value to ESMA to hear the SMSGs' opinion on specific topics, in particular if they have been discussed at prior joint meetings.
12. A further important tool to strengthen consistency in supervisory outcomes are peer reviews of NCAs. Art. 30 (1) ESMA Regulation No 1095/2010 requires ESMA to develop methods which allow for objective assessment and comparison between NCAs. As a first step, during 2013, ESMA set out methods and tools on how to conduct peer reviews (ESMA/2013/1709) and ESMA has since then further developed these principles.
13. The SMSG agrees with ESMA that the focus of the peer reviews should differ depending on the topic of the relevant peer review. If a peer review looks at the legal framework and its interpretation by NCAs (i.e. if it relates to the single rulebook), a peer review should assess whether *uniform standards* are applied by the NCAs. However, if the focus is on supervision and enforcement (e.g. monitoring markets; or sanctions imposed by the NCAs), a peer review should rather aim at achieving *best practices* while taking into account the different structure of markets and market participants in the Member States.
14. As regards the enforcement aspect of supervisory convergence, the SMSG would like to encourage ESMA to pay greater attention to the ways in which NCAs supervise markets, in particular regarding information provided by issuers under Union law (corporate disclosure: prospectuses; financial reports; inside information; notifications about directors' dealings; notification about changes of major shareholdings; disclosure of information relating to corporate governance issues). When examining the timeliness and correctness of such information provision, do NCAs apply a risk-based approach or do they carry out a full review?
15. The new legal framework (Market Abuse Regulation; MiFID-II; Transparency Directive; etc.) provides a strict sanctioning regime for all Member States. It will be of utmost importance that administrative sanctions (in particular, fines and the publication of the infringement) will be imposed in an as consistent manner as possible across the EU (taking into account the minimum harmonisation approach of the level 1-acts). ESMA has already highlighted the importance of enforcement activity by NCAs in its Peer Review Report on MiFID Suitability Requirements (ESMA/2016/584). The SMSG asks ESMA to, also for other themes, consider the necessity of convergence of enforcement in ESMA's future supervisory convergence work programme. It will be important to clarify whether NCAs do sanction market participants in every single case of violation of Union law or, if not the case, under which conditions they refrain from taking action (as they have discretion to do so under national law). Does this depend on the severity of the infringement or other aspects, such as resource constraints at the NCAs?

2. "Enforcement" of results gained by peer reviews

16. ESMA has no powers to require NCAs to apply best practices identified in peer reviews (its powers are restricted to potential breaches of Union law). Nevertheless, ESMA has developed methods which might contribute to the adoption of best practices by the NCAs. It remains to be seen whether the publication of the results of a peer review on a named basis is sufficient to ensure supervisory convergence or whether additional action may be required.
17. ESMA may wish to consider enhancing the effectiveness of peer reviews by explicitly covering NCAs compliance with ESMA's Guidelines where appropriate. ESMA's guidelines are in general more detailed than Union law and thus contribute meaningfully to supervisory convergence. NCA's are required to declare compliance (or explain any deviations). By highlighting best practices and any deficiencies in complying with respective guidelines, ESMA will give guidelines "teeth".
18. In any case, a follow-up peer review (as laid down in ESMA's Review Panel Methodology ESMA/2013/1709) including a letter sent from the Chair of ESMA to the head of the NCA/representative of the NCA in the Board of Supervisors (BoS) will help to draw the attention of NCAs to deficiencies determined in the peer review processes and to underline the importance attached to this matter. It is important that the Review Panel reports back to the BoS and suggests suitable responses in case of possible delays in implementation. The SMSG observes that this approach has already been successfully adopted with regard to supervisory practices under the MAD (ESMA Follow-up Report, Peer Review on Supervisory Practices against Market Abuse, ESMA/2015/1905).

IV. Engagement of stakeholders

19. Stakeholders can contribute to ESMA's work on supervisory convergence in a variety of ways. On the one hand, they may have experienced different interpretations of Union law by NCAs, in particular in cross-border transactions and on the other hand, they also have insights in the enforcement practices of NCAs and might be aware of deficiencies. Therefore, stakeholders should be involved in ESMA's work on supervisory convergence.

1. ESMA's initiatives and activities

20. The easiest way for ESMA to learn from stakeholders' experiences is to establish a hotline. In fact, ESMA allocates a section on its website to allowing the public to submit complaints on trade repositories as well as on credit rating agencies (<https://www.esma.europa.eu/about-esma/esma-in-short/complaints>). If a stakeholder wishes to complain about another financial market participant, ESMA currently refers to contacting the relevant NCA. It is also possible to complain about a NCA. But ESMA makes clear in this context that it will only have powers towards NCAs in case of a breach of Union law.
21. The SMSG understands that ESMA generally does not have power to investigate or take action against a financial market participant other than a credit rating agency or a trade repository. However, it would be of great importance if ESMA had the possibility to learn from stakeholders whether there is weak enforcement by NCAs. The SMSG therefore welcomes ESMA's initiative to engage stakeholders in peer reviews.
22. ESMA's principles (ESMA/2016/632) split stakeholders in two categories. *Category A* comprises entities which have been entrusted with some supervisory/oversight functions (but are not considered as NCAs), whilst all other stakeholders, such as issuers, credit institutions, fund managers, law firms etc. belong to *category B*. According to ESMA's principles, any stakeholder interaction is subject to

approval by the Board of Supervisors (BoS). NCAs are not permitted to veto engagement with *category A stakeholders*. However, NCAs have discretion to refuse engagement with *category B stakeholders*. It is generally the NCA which organises meetings with relevant stakeholders. According to ESMA's principles, the nature of the interaction with stakeholders should be related to market intelligence and general information.

23. The SMSG does understand why NCAs have a say in whether and how stakeholders are to be engaged in peer reviews. However, with regard to the limited scope and rights of the Assessment Group established by ESMA, one should not expect too much from future interaction with stakeholders. It is hard to imagine that ESMA would learn from stakeholders about weak enforcement or even "strategic" decisions not to enforce.

2. Involvement of the SMSG

24. Against this background, and our initial reactions as presented above, the question is how the SMSG could further contribute to ESMA's supervisory convergence work, in particular to peer reviews. As already stated the SMSG has the task to provide advice to ESMA on supervisory convergence (Art. 37 ESMA Regulation 1095/2010). Furthermore, the SMSG may request ESMA to investigate alleged breaches or non-applications of Union law (Art. 17 (2) ESMA Regulation 1095/2010). This already happens based on personal experience of the members of the SMSG. The SMSG has debated whether to allow direct access to the public, e.g. with the Steering Committee serving as a gatekeeper who will sort the incoming addresses before these reach the whole SMSG. Due to the limited resources available to it, it should be made clear that the SMSG would have full discretion as to which issues it chooses to take forward for discussion with ESMA.
25. If the public gets access to the SMSG, the SMSGs' Rules of Procedure have to clarify as to how the receipt of relevant information should be handled. The governance of this process would be quite complex. First and foremost, it would have to be determined whether it is the task of the Chairperson/the Steering Committee to decide how to proceed.
26. During the debate of this issue, many considerations and concerns were aired. At the end of the term, the current SMSG does not feel it is in a position to decide on this fundamental and difficult issue. The topic should be discussed by the SMSG with new composition in the second half of the year. For this reason, the pros & cons of this question from our extensive debate are restated in the End of Term Report to which this paper refers.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

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