

ADVICE TO ESMA

2021-22 Peer Review Work Plan – Call for input on possible peer review topics

I. Introduction

1. Peer Reviews are a key instrument of ESMA to increase supervisory convergence. In view of ESMA's limited resources it is important that the peer reviews are organized on the topics where such reviews are most useful. The SMSG therefore highly appreciates the opportunity to provide input on ESMA's Peer Review Work Plan in an early stage.
2. In respect of mandatory peer reviews, the SMSG will not provide input, since they are required by law. The SMSG focuses this advice on the discretionary peer reviews, both for 2020-2021 and for 2021-2022.

II. Input in regard of Discretionary Peer Review in 2020-2021

3. ESMA proposes to hold discretionary peer reviews on two topics for Q4 2020 to Q4 2020:
 - *Brexit: handling of relocation to EU 27 in the context of the UK's withdrawal from the EU*
 - *Supervision of cross-border activities of investment firms*

As discussed at previous SMSG meetings, the SMSG agrees with the importance of supervisory convergence in those areas and fully supports those peer reviews topics. Nevertheless, the SMSG has a number of recommendations in respect of the precise content of those topics.

4. In respect of the Peer Review Topic "*Brexit: handling of relocation to EU 27 in the context of the UK's withdrawal from the EU*", the SMSG is of the opinion that, it is particularly important to include in this peer review the following aspects:
 - In the absence of MIFID2/R equivalence, how different NCAs control the use of reverse solicitation (and any other measures which may skirt equivalence);
 - How different NCAs approach the issue of delegation under the UCITS framework; and
 - How systematic Internalizers' activities are supervised.

Those aspects also have a wider relevance than Brexit. If they would not be fully assessed during the scheduled Brexit peer review process, they should be considered as independent peer review topics for the next year.

5. In respect of the Peer Review Topic "*Supervision of cross-border activities of investment firms*", the SMSG is of the opinion that it is important to particularly look into cross-border activities of investment firms *within the EU*.

ESMA has dealt with supervision of cross-border activities of investment firms in the past, particularly in respect of investment firms established in certain Member States and selling products to retail investors in the EU, without complying with the applicable selling rules. The problem is that the incentives for a home Member State NCA to effectively supervise activities of its investment firms in another EU member state, are not very strong. This is particularly relevant if those services are provided to retail clients. This may have a number of undesired effects, such as *forum shopping* in respect of the investment firm's authorisation, an unlevel playing field between investment firms established in different member states, and investor protection concerns. Therefore, the SMSG suggests to clarify the scope of this peer review and to specify that the peer review will deal with "supervision of cross-border activities of investment firms in the EU".

III. Input in regard of Discretionary Peer Review in 2021-2022

6. Taking into account the criteria of the Peer Review Methodology, the SMSG suggests the following peer review topics for 2021-2022. The SMSG is of the opinion that more convergence is most urgently needed in respect of the following topics:

- Inducements
 - o Quality enhancement

Studies by several national competent authorities show that many investment firms are not fully meeting the obligations under the MiFID II quality enhancement rules, and that competent authorities often have differing interpretations of the quality enhancement criteria.¹ ESMA's Technical Advice on inducements also notes that many respondents to its consultation on this topic reported that "competent authorities have differing interpretations of the quality enhancement criteria for acceptable inducements." In particular, meeting the needs of the quality enhancement test may be more challenging in the context of execution-only sales, and would be worthy to investigate further in a peer review.

¹ For instance:

- A recent [Thematic Review](#) by the Danish Financial Supervisory Authority found that the quality enhancement test was in many cases not appropriately applied by investment firms. For instance, Danish financial advisers often regarded certain general services that are widely available to all banking clients (such as general newsletters sent to all clients or access to online banking) as 'quality enhancing'. In addition, some of the quality enhancing services provided to consumers were not considered relevant by the Danish FSA for the purpose of the quality enhancement test (for instance, offering a physical advisory meeting to an execution-only client, who has already chosen to forego advice).

- In Norway, the Norwegian supervisor carried out a [survey](#) of how investment firms were complying with the quality enhancement test, and found that many firms were not properly applying the rules. The Norwegian supervisor specifically raises the point that the proportionality requirement under the quality enhancement test could mean that "there may be cases where the remuneration received is so high that further service offers can hardly be sufficient added value. In such cases, the excess remuneration must be returned to the customer."

- In Germany, according to the [national law](#), having a "widespread network of branch offices" (including in rural areas) is sufficient to meet the needs of the quality enhancement test. In 2017, the Bundestag scientific committee came to the [conclusion](#) that the German national law is not in line with the requirements of the European law.

- Duty to act in best interest of client

Concerning the MiFID II requirement to ensure that inducements do not impair compliance with a firm's duty to act in the best interest of their clients, there are concerns that products advised to consumers are significantly costlier compared to alternatives available on the market, with inducements playing a key role in driving adviser recommendations. It would be very useful to conduct a peer review to chart whether and how supervisors deal with those practices.

Given the evidence and the need to ensure supervisory convergence in Europe, the above topics would be very relevant for a peer review.

- How different NCAs control the use of reverse solicitation (and any other measures which may skirt equivalence), if this topic has not been fully reviewed during the Brexit peer review process of 2020-2021.

7. In respect of the following items more convergence is also highly desirable. It should be noted that in respect of those items, SMSG members have different views on what peer review issues are most urgent, and that, therefore, the order in which the issues are mentioned does not reflect the urgency of the matter.

- Short selling bans

Following up on the recent SMSG advice in respect of short selling bans in the COVID19 context, it would be interesting to conduct a review of the application of short-selling bans by NCAs. Faced with a similar set of circumstances, NCAs arrived a different decisions, and where bans were instituted the interpretation/guidance has differed.

- Product intervention measures

Following up on ESMA's call for evidence on product intervention, and the SMSG's two pieces of advice on that topic, it would be very useful to conduct a peer review on the application of product intervention measures. Notably, certain soft-law measures predated MIFIR, and the SMSG has in the past called for a post-MIFIR review. In certain cases these measures persist or have been reinforced.

- Third country access to trading venues

It would be useful to engage in a peer review process on NCAs' approach to third country access to trading venues, including Direct Electronic Access. As this is not regulated at EU level, there are different interpretations and regulation. An overview and convergence would be beneficial.

- Outsourcing within the EU and to third countries

There seems to be an increased focus on outsourcing, especially towards third countries, including to cloud providers. A peer review would be beneficial to get convergence.

- Incident reporting and handling

Peer Review would moreover be useful in regard of incident reporting and handling by NCAs, including structures for lessons learned. More convergence would strengthen the ability for risk mitigations on a EU level.

- Education initiatives
- Systems for market abuse supervision

It would be very important to conduct a peer review on the systems used by NCAs for the surveillance of market abuse and their effectiveness. Certain NCAs use systems which are not state of the art and there is much to gain from supervisory convergence on this issue.

- Compliance with UCITS and AIFM Directives

It would be useful to conduct a peer review on how NCAs investigate non-compliance with the UCITS and AIFMD Directives, and on the way NCAs adopt sanctions, if any.

- Distance distribution modes (digital offers)

It would be useful to conduct a peer review and mapping on the distance distribution modes (digital offers) under the Distance selling Directive and how they are supervised by NCAs.

- Non Financial Reporting

Most of the regulations on sustainable finance are too recent to be peer reviewed in the coming 2 years. However there is one topic that should be reviewed by ESMA: non-financial reporting. The third reporting cycle under the Non Financial Reporting Directive (NFRD) is almost finished and at least two more cycles will be managed within the same regulatory framework. There are many differences in how the NFRD is applied and supervised in different Member States and the need for convergence is high. This peer review could study the following issues:

- o how was the NFRD transposed in different member states?
- o to what extent do NCAs supervise non-financial reporting?
- o what information disclosed in non-financial reports is coherent and comparable and what are shortcomings (mainly from the point of view of reports users, such as investors, analysts, fund managers etc.)?

Adopted on 8 June 2020

[signed]

Veerle Colaert

Chair

Securities and Markets Stakeholder Group