Financial Services Authority

Working towards effective and confident European Supervisory Authorities

The FSA's views on policy considerations

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1 Governance, organisation and resources

The FSA welcomes the agreement on the establishment of the European Supervisory Authorities (ESAs). We are strongly committed to the success of the ESAs. We want to share our current thinking about how to give practical effect to the vision for the ESAs, which has been set out in legislation.

This is not an exhaustive list of issues that need to be discussed. We look forward to hearing from our counterpart regulators and supervisors about which issues they see as priorities.

1. Strong, independent organisations based on national supervisor membership

The FSA believes that the ESAs should be strong, independent organisations. The foundation for that strength and independence lies in their members, the national supervisory authorities. The role of the ESAs is to deepen the single market, raise supervisory standards and help mitigate crises through the following key tools:

- exercising powers in an emergency and temporarily banning financial service activities;
- developing a single rule book;
- investigating breaches of EU law;
- settling disagreements between supervisors, using binding powers to ensure compliance with EU law;
- enhancing colleges of supervisors; and
- undertaking peer review.

The ESAs will best achieve this by working with their members, and their members will best achieve it by working constructively with each other and with the ESAs. The structures and functions of the ESAs should reflect this membership-based approach, which is in line with the complimentary, symbiotic role for both the ESAs and national competent authorities set out in the legislation.

2. Good governance

Good governance should be a universal principle and will also apply to the ESAs. The chairmanships and terms of reference of standing committees (as permanent sub-committees) and working groups (as ad hoc groups with a pre-defined lifespan) should reflect the membership-based approach.

To promote good governance, we suggest that the standing committees should normally be chaired by a member of the Board of Supervisors. Working groups should be chaired by experts from the member states or, if necessary, by ESA staff. The working groups should be appointed for a certain time period which could be extended by the Board of Supervisors. Terms of reference for these committees and groups should be explicit and approved by the Board of Supervisors.

3. Delegation of power

Particular care should be taken when assessing whether significant powers and tasks may be delegated from the Board of Supervisors or the Management Board. Delegation of tasks or powers provided for in the Regulations should be agreed and minuted by the Board of Supervisors. However, the Board of Supervisors should not delegate critical powers, such as: formal voting power; agreement of terms of reference for standing committees or working groups; or the exercise of emergency powers when the Council has declared an emergency. In emergencies, the Board of Supervisors in plenary session should discharge responsibilities directly. Although some business may need to be done by a sub-committee of the Supervisory Board, powers in relation to policy issues should not be delegated to the Management Board. ESA staff should perform a Secretariat function.

4. Discharge of functions

Key functions of the ESAs – such as draft rule making, investigations, exercise of emergency powers – could be led at working level either by ESA staff or by expert groups chaired, as now, by national supervisors. When deciding how these functions should be discharged, the following considerations appear relevant:

- Are the issues highly political?
- Do the issues require significant specialist expertise?
- Do they involve judgments of the quality of supervision?

In such circumstances, it would seem sensible that the Membership should lead through standing committees (and working groups below the standing committees), with the ESA staff providing secretariat support. This might include work on issues such as: supervisory colleges, peer review, relations with the European Systemic Risk Board (ESRB), the banning of activities, supervisory convergence and fiscal safeguards. Draft rule-making and guidance should also lie with standing committees and working groups, since these groups have the economic, technical and legal expertise to produce rules that will not need transposition, expertise which an ESA will probably lack, at least in the short-term.

In the short-term – due to resource constraints – we believe that the ESAs will need to draw on the resources of member states. The ESAs will need to rely on national supervisors' expertise in policy and legal drafting. If, over the longer term, the Secretariat is to take on this work, it will need significant numbers of specialist lawyers and regulatory economists with Cost Benefit Analysis (CBA) experience. The FSA therefore recommends that the Level 3's current proposals on organisational structure and staffing levels are developed so as to be able to meet envisaged needs. Seconded national experts already are an integral part of the Level 3 Committees. Their value should remain recognised in the ESAs.

5. Risk-based approach

We believe that the ESAs should take a risk-based and outcomes-focused approach. Their organisational structures should reflect the key tasks they have been given. These are:

- developing the single rule-book;
- undertaking economic analysis of financial markets;
- investigating possible breaches of EU law;
- undertaking mediation;
- undertaking peer review;
- contributing to colleges of supervisors;
- promoting consumer protection;
- establishing and maintaining strong relations with the ESRB; and
- directly supervising credit rating agencies.

In addition, it is essential that a high level of attention is given to transforming the three Level 3 Committees (3L3) into the Joint Committee of the ESAs. Procedural rules for the relationship between the ESAs and the Joint Committee will be needed. These will need to make clear that consistent approaches to issues affecting more than one sector are expected. It is essential that the ESAs' consultation practices in their Joint Committee work are open and wide-ranging.

2 Binding technical standards

1. Principles

We believe the ESAs should follow a proportionate approach to rule-making. They should be mindful of the principle of subsidiarity, which asserts that 'the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States'. These principles are required by article 5(3) of the Treaty on European Union which is also explicitly referred to in recital 66 of the ESA regulations. Policy issues should be prioritised according to pre-defined criteria.

Where the sectoral legislation is permissive on whether a binding technical standard (BTS) is to be drafted, an evidence-based approach should be followed to decide whether a rule is necessary. If it is decided that a rule should be drawn up, a consideration of other priorities and resources should determine when the work on developing the standard takes place.

The use of CBA in rule making, whether on its own or as part of a wider impact assessment (IA), is an accepted practice. It was an important part of the Better Regulation agenda adopted by the Commission and endorsed by the existing Level 3 committees. The Commission has re-iterated its support for this agenda, for example, in its Communication on Smart Regulation.[1] In accordance with these principles, the FSA believes CBA and consultations should be undertaken for all BTS. This should be achievable if a graduated and proportionate approach to the CBA and impact assessment (IA) is followed and it is accepted that a high-level CBA may be appropriate in urgent or minor cases. The ESAs should draw on the expertise of the IA Adviser network in undertaking work, and BTS and guidelines should be subject to periodic CBA review. Where the review shows a BTS or guideline is no longer needed, the relevant ESA should propose its removal.

2. Drafting the BTS

It is essential that the BTS are drafted to a very high technical quality. They must be clear, concise and unambiguous following the principles set out in the 'Joint Practical Guide for the drafting of Community legislation'.[2] To avoid unintended effects, the

1 COM (2010) 543
2 http://eur-lex.europa.eu/en/techleg/pdf/en.pdf

rules of procedure should provide for legal input from all member states and there should be a continuous dialogue with the Commission (legal services) to draw on existing expertise.

The current arrangements for Level 3 Committee working groups of national supervisors concerning preparation of advice for the Commission and other Level 3 policy making have proven successful and should be maintained for drafting BTS and guidelines. The Rules of Procedure should formally provide for BTS and guidelines to be drafted by standing committees drawn from the national authorities.

3 Binding mediation

The ESA regulations provide for powers of both binding and non-binding mediation and give the ESAs a role in settling disagreements between competent authorities in cross-border situations. Non-binding mediation already exists as a mechanism of the Level 3 committees however binding mediation is a new power under the ESA regulations.

1. Non-binding approach to mediation preferable

The FSA has a preference for non-binding mediation, when that is the preference of the parties. The Omnibus Directive has amended sectoral legislation to permit binding mediation to occur in areas specified by the sectoral legislation[3], and may be initiated by either party to a dispute or on the ESA's own initiative where predefined criteria are in place. In these areas a non-binding approach at the conciliation phase is nonetheless still envisaged.

2. Binding mediation

Article 19 sets out two phases for the settlement of disputes between competent authorities. The first one (Art. 19 II) we refer to as conciliation. The second (Art. 19 III, IV) is arbitration.

2.1 Conciliation

Conciliation should support voluntary settlement of disputes as much as possible by pursuing a facilitative approach where a mediator tries to broker a voluntary settlement. This would build on the existing, non-binding approach to mediation in Level 3 committees.

The regulations provide for a mediation panel to decide binding mediation cases. This panel will comprise the Chairperson and two other members of the Board of Supervisors who are not parties to the dispute. The mediation panel should be able to delegate responsibility to a mediator or mediators where the disputing parties can agree the delegation. The FSA believes that it should be the prerogative of

3 See, for example, Art. 58a of MiFID (as added by the Omnibus Directive).

the parties to choose the mediator(s). The mediator should be guided only by the need to ensure that the course of action proposed is in compliance with EU law, and that it is satisfactory to both parties and should not be guided by personal or institutional interest. The mediator should have access to expert advice including high-quality legal advice.

2.2 Arbitration

Arbitration, which arises if conciliation fails, should be led by the mediation panel. The mediation panel can only act to ensure compliance with EU law and cannot replace the lawful exercise of a competent authority's discretion. The mediation panel should not delegate responsibility for drafting decisions at this stage. When recommending a decision, the mediation panel will need to ensure appropriate checks and balances, especially on the assessment of compliance with EU law.

4 Supervisory colleges

1. Supervisory colleges/ESAs relationship

Supervisory colleges are a key tool in delivering improved supervision of cross-border firms, and the ESAs are entrusted with a leadership role in ensuring a consistent and coherent functioning of supervisory colleges. For the purposes of its college functions, the ESAs will be considered a 'competent authority'. They should seek to ensure that colleges achieve their objectives by considering the key issues relevant to the group being supervised. European supervisors should seek to improve the supervision of cross-border firms through regular communication, sharing information and reaching joint decisions where appropriate. ESAs should not seek to influence the supervisory decisions that the members of the colleges need to take collectively unless any such decision would be unlawful.

Supervisory colleges should be free to focus on key issues relevant to the group. ESAs should play a key role in supporting the successful rollout of colleges providing best practice tools and guidance. It is important that any binding technical standards or guidelines in this area set the right framework and identify key outcomes. They should not seek to set out in exhaustive detail the key issues relevant to the group that is being supervised, since the range of issues will be specific to individual firms. The FSA welcomes the work of the Level 3 committees in designing best practice guidance on colleges and believes that it is important that such guidance focuses on ensuring that colleges cover the issues most relevant to the group being supervised.

2. Implementation of current guidelines

ESAs should monitor the implementation of current guidelines on colleges and review them when it becomes possible to assess both the success of the guidelines and where they can be strengthened. At that point, it would be right to consider whether binding technical standards or guidance would best serve the objective of securing successful and focused colleges. However, it is important to give the existing, recently agreed guidance time to bed down before reviewing it. When it is reviewed, there should be no prior assumption as to whether the guidance should be amended or replaced by binding technical standards. It will be necessary to consider at the time of review which method would be more effective in ensuring that colleges can provide suitably tailored and effective supervision of relevant groups.

5 Emergency powers

In an emergency situation the focus of the ESAs should be on coordination as this will be the most useful function. It is essential that any exercise by an ESA of its emergency power meets the requirements of EU law. In particular, this requires that the exercise of the power:

- falls within the scope of the ESA's powers;
- satisfies the proportionality and subsidiarity requirements;
- complies with the principles of the Meroni decision, i.e. that the ESA is not exercising a wide discretionary power which involves economic policy choices; and
- does not breach the provision on fiscal safeguards.

It is therefore necessary that any proposed emergency decision is checked to ensure that it is not *ultra vires* or otherwise contrary to public law. In particular, if a proposed exercise of an emergency power appears to test the bounds of the ESA's views of the extent of that power, then the input from the appropriate legal expert body should first be obtained. (We suggest, below, that the ESAs should set up a standing panel of competent authority lawyers to consider potentially contentious or important legal issues, and this might be an area where such a panel could play an important role.)

It will be important that the ESA assesses whether the proposed decision would have a disproportionate effect on the member state, competent authority or the institutions concerned. It should also assess whether the desired outcome could best be achieved by action at the member state level. The ESA will need to provide adequate reasons for its decision.

It is clear that the conditions in Articles 9 and 18 for the exercise by an ESA of its emergency and temporary banning powers may themselves create the risk of legal challenge to an ESA. This could come, for example, from financial institutions adversely affected by such decisions. Therefore, the FSA suggests the ESA mitigates this risk by harnessing the legal resource that already exists with national supervisory authorities. This might best be done by establishing a standing panel of competent authority lawyers (analogous to the 'IA Net' economist body in the CBA

context, with which the L3 Committees are already familiar). The panel could be asked for its views on a proposed exercise of power, involving a new or contentious legal issue, which would then help the supervisory board when making its decision.

The fiscal responsibilities safeguard (Art. 38 ESA Regulation) was a key concern to some member states. It is important therefore that the ESA should assess whether an emergency decision (or a binding mediation decision) impinges in any way on the fiscal responsibilities of the member state concerned. In approving a decision, the Board of Supervisors must certify that it believes that there is compliance with Article 38.

6 Investigation powers

The ESA Regulation provides for a three-stage investigation mechanism to investigate alleged breaches or non application of Union law. The following comments focus on the decision to initiate an investigation and how such an investigation will be carried out.

The investigation process should be designed to be fair, transparent, proportionate and responsive to the issues in question. It should be consistent with any stated policy that the ESA publishes.

The investigative function should have a clear home within a department of the ESA and the investigations themselves should be conducted by investigation teams assembled on an ad hoc basis comprising persons with the requisite skills who could be ESA staff, staff from other authorities or outside experts. Cases should be filtered to check that they are suited for investigation. The filtering process should contain certain criteria for commencing investigations which include *inter alia* proportionality and possible consequences of the alleged breach of or non-compliance with Union law.

Given the legal and political significance of mounting a formal investigation into whether a competent authority is in breach of or has not applied Union law, the decision-maker should be the Board of Supervisors.

7 Consumer protection remit

The FSA supports the consumer protection objectives given to each ESA, and the particular roles and tasks assigned to them as part of their oversight of their sectors. The consumer objectives include maintaining a degree of oversight of the products/services offered to consumers in each sector and any issues arising, along with roles in respect of consumer education and compensation/guarantee schemes. We believe that each ESA should develop and apply an effective but proportionate and risk-based approach to meeting their consumer protection objectives and carrying out the particular tasks assigned to them.

We suggest that, to the extent possible within the context of the relevant EU legislation, the ESAs should consider the different degrees of protection necessary for retail customers as opposed to non-retail customers who, in general, are better able to look after their own interests or to employ professional assistance.

On many issues national authorities will be closer to consumers and so will be better able to understand their behaviour and the particular risks they face. Close cooperation between the ESAs and the national authorities on the delivery of these objectives will therefore be vital.

As a first step, each ESA will need to ensure that it has the necessary internal committee and governance structure to consider and develop its thinking on its consumer protection objective and roles. The role and approach of the Joint Committee of ESAs will also be important to ensure cross-sectoral consistency.

8 Conclusion

The FSA is committed to making the ESAs successful institutions. To achieve this, the ESAs must be strong and independent, membership-based organisations that draw on the expertise of their members. They must act in a way that is proportionate and risk-based and the ESAs and their members must work closely together to ensure success. It is therefore important for all members across Europe to engage in an early discussion on how the ESAs can best be structured and organised. We hope that this paper facilitates this dialogue. We recognise that this is not an exhaustive list of issues that need to be discussed and we are looking forward to hearing from our counterparts about which issues they see as priorities.

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