

Valdis Dombrovskis
Vice-President
European Commission
Rue de la Loi 200 / Wetstraat 200
1049 Bruxelles/Brussel
Belgium
Sent by email:
fisma-esas-consultation@ec.europa.eu

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Subject: Public consultation on the operations of the European Supervisory Authorities

Dear Mr. Vice-President,

Accountancy Europe is pleased to provide you with its comments on the Public consultation on the operations of the European Supervisory Authorities (ESAs), as this is a key matter for the financial sector in the European Union (EU) and with great impact on financial reporting, accounting and auditing.

However, due to the limited consultation period - two months instead of the usual three - Accountancy Europe cannot be expected to bring together all the planned input and therefore opted to submit comments on key topics relating to financial reporting and auditing instead of a detailed response to all aspects of the consultation. In addition, the consultation paper is scarce on problem analysis regarding key issues as well as on the arguments for some of the proposals, making it difficult to discuss and assess their various respective merits. As ESAs have moved convergence of supervision forward, it is not the time now to change their mandate and role significantly.

In theory, we can consider different scenarios for financial supervision in the EU and we remain committed to contribute to an informed discussion in this area but a thorough analysis of the pros and cons of the available models is key before taking any decisions.

The transfer of supervisory competences to the ESAs should also be assessed in the light of the current political climate in the EU (Brexit, national elections, etc.). There is an increasing scrutiny by EU citizens on centralization initiatives or the transfer of powers and any move in this regard should be sufficiently clear and duly justified. We suggest the Commission to rethink this approach when structural issues – as is the case of the European System of Financial Supervisors - are at stake.

We hope, nevertheless, that the Commission will find the comments below useful.

ACHIEVEMENTS OF THE ESAS TO DATE

Supervisory and regulatory convergence are key aspects for financial markets integration and ultimately for the achievement of a Capital Markets Union (CMU) in the future. The ESAs have been developing a valuable contribution towards the creation of a true level-playing field at EU level and should continue this by fostering consistency in the application of the Single Rule Book by the National Competent Authorities (NCAs).

We believe that the role of ESAs is also crucial for monitoring the implementation of the EU legislation for consumer and investor protection. At present ‘gold plating’ of EU legislation at the national level can result in a high regulatory barrier to the single market and in particular the development of the CMU.

The ESAs also have the potential to perform a crucial role in assessing the impact of financial services regulation in a holistic manner. The cumulative impact of the numerous requirements contained in different pieces of legislation applicable to the financial services industry results in a high regulatory burden, which needs a proper cost/benefit assessment as it creates a barrier to the development of European capital markets.

MORE POWERS FOR ESAS?

Supervision of market participants in the financial sector is so far a national competence based on the mutual recognition of authorisations and supervisory systems across the EU.

In accordance with the principle of subsidiarity, NCAs are considered to be better positioned to deal with national specificities in terms of oversight, and are therefore considered to be more effective.

As financial markets become more integrated in the EU, the transfer of powers to the EU level might become a long-term goal but it is important not to lose sight of the rationale underlying this transfer: effectiveness of supervision. Such transfer of powers should at least outweigh the disadvantages that may result from the distance and less detailed knowledge and insights that the ESAs have with respect to the local entities and businesses compared to NCAs. This is particularly relevant regarding direct access to data by the ESAs, which remains a national competence.

As an overarching remark, we think that ordinarily the establishment of a truly harmonised framework at EU level is a prerequisite to the creation of, or transfer of powers to, a supranational authority; it is usually counterintuitive to be the other way around. In the absence of a harmonised EU framework, which might be achieved in the longer term, ESAs should coordinate the implementation and enforcement at a EU level in order to ensure that differences in national implementation do not lead to undue barriers to market integration. In this regard, ESAs should continue to foster consistency of practices among NCAs.

The transfer of supervisory competences to the ESAs should also be assessed in the light of the current political climate in the European Union (Brexit, national elections, etc.). There is an increasing scrutiny by EU citizens on centralization initiatives or the transfer of powers and any move in this regard should be sufficiently clear and duly justified.

For instance, regarding the specific case of the approval of internal models under the Solvency II regime by the European Insurance and Occupational Pensions Authority (EIOPA) for cross-border groups, there are additional reasons to keep this competence at national level. The approval of internal models should go hand in hand with the respective supervisory powers. This should not be excluded in the long term, but for the moment EIOPA does not have the resources to directly supervise insurance undertakings nor is there such a need. A good understanding of the local markets is key, especially in the insurance sector, and therefore NCAs are often better positioned to perform these tasks.

FINANCIAL REPORTING

To our surprise, in addition to the operation of the ESAs, financial reporting was particularly focused in the consultation paper, namely the endorsement and enforcement of accounting and auditing standards, with direct implications on the role of European Financial Reporting Advisory Group (EFRAG) and the Committee of European Audit Oversight Bodies (CEAOB).

Whenever there is a need for improvements, we are open to engage in a constructive discussion on possible ways to enhance the institutional framework and the process in both areas as they are at the core of our activities. Nevertheless, we believe that in both cases the discussion is premature at this point in time, and that the rationale for the proposed changes, namely the empowerment of European Securities and Markets Authority (ESMA), is not sufficiently clear nor justifiably argued.

Furthermore, accounting and audit should be addressed separately as these two areas raise different issues and, although linked, do not have necessarily synergies between them, as suggested in the consultation paper.

ACCOUNTING AND FINANCIAL REPORTING

Streamlining and achieving increased consistency in financial reporting can be achieved, at least partially, by maximizing the extent to which regulatory requirements refer to the application of International Financial Reporting Standards (IFRS) (or IFRS as adopted for use in the EU). Regarding accounting and financial reporting, although not mentioned in the consultation paper, EFRAG plays a key role in the endorsement for use in the EU of the IFRS issued by the International Accounting Standards Board (IASB) and has a track record of high quality output in this area.

EFRAG recently underwent a comprehensive reform of its governance structure as a result of the implementation of the Maystadt report¹ recommendations. Improvements were made within EFRAG, it is therefore too early to assess the impact of such changes and to discuss undefined potential problems regarding the endorsement of accounting and financial reporting standards. In addition, EFRAG, as any other organisation, needs stability to focus on its core mission; part of this stability was provided by the recently approved funding until 2020.

Concerning the enforcement of accounting and financial reporting standards, the potential advantages, if any, of combining it with the endorsement function should be properly spelled out and clearly outweigh its potential conflicts of interest as well as the increased risk of a move towards rule-based standards, as they could be developed having enforcement as their first objective.

Conversely, the need for specialised expertise and resources to conduct such tasks should also not be underestimated, as it will certainly lead to an increase in ESMA's operational costs, wasting the experience EFRAG has built up over 15 years in its combined functions of influencing the IASB.

On the short term ESMA, as well as the other ESAs, should consider participating more in the process, perhaps by becoming full EFRAG members', as suggested in the Maystadt report; this would benefit the agencies and potentially enhance the process as well as the agencies' understanding of the various stakeholders already taking part.

AUDITING

Concerning auditing, especially the audit oversight system, we also question whether this is the right time to relaunch the debate.

The CEAOB was only established in June 2016, following the audit reform in the EU, and it is still in its start-up phase. The set-up of the CEAOB was the choice of the European legislators as the step forward in terms of cooperation between NCAs, highlighting the role of Member States in this area.

As the audit reform implementation is still in progress in some Member States, it is more than premature to draw any conclusions on the functioning of the new oversight framework in the EU. Additionally, Article 40 of the Audit Regulation states that “*The Commission shall review and report on*

¹ Available here: http://ec.europa.eu/finance/company-reporting/docs/governance/reform/131112_report_en.pdf. The transfer of powers in this area to ESMA was also considered in the report but was not the option taken.

the operation and effectiveness of the system of cooperation between competent authorities within the framework of the CEAOB [...] The Commission shall complete its review by 17 June 2019², establishing a more feasible timeframe to properly assess the functioning of the CEAOB.

In theory, we can consider different scenarios for audit oversight across the EU and we remain committed to contribute to an informed discussion in this area. The proposed solution of integrating the CEAOB in ESMA is only one of the options available and is not new².

The European Commission now points to two reasons for this proposal: (1) enhancement of supervisory convergence and (2) potential budgetary implications.

Regarding the first reason, it remains to be truly demonstrated how supervisory convergence and harmonisation would be better achieved by simply integrating CEAOB in ESMA. Transferring competences from NCAs to the EU level does not automatically ensure convergence and harmonisation in supervisory practices, as NCAs will still be the local interlocutors.

The supervision of statutory auditors and audit firms across the EU often requires a deep understanding of the national specificities in terms of the applicable framework, for instance in the field of accounting and company law. For this reason, NCAs and professional accountancy bodies are often better positioned to deal with these specificities in accordance with the principle of subsidiarity.

Concerning the budgetary implications, it is key to have an estimation of the expected impact in both the European Commission's and ESMA's budget, in order to properly assess the cost-benefit of transferring these competences to ESMA, as for the moment ESMA does not have sufficient resources nor expertise to be in charge of the audit oversight system at EU level.

Lastly, the implications on ESMA's governance should not be overlooked, as for the moment only six CEAOB members are full ESMA members.

STAKEHOLDER CONSULTATION: DEVELOPING THE RIGHT CULTURE

According to their founding Regulations, ESAs should consult interested parties on regulatory or implementing technical standards, guidelines and recommendations and provide them with a reasonable opportunity to comment on proposed measures. Therefore, stakeholders groups are key to ensure that interested parties can contribute to the policy process.

As ESAs grow in competences and areas of work, especially in the case of ESMA, stakeholder engagement – or in fact stakeholder integration - becomes even more important. This is part of good governance and indispensable to having up-to-date market understanding and competences, as a reality check and to becoming more transparent.

In order to achieve effective stakeholder consultation, we propose the creation of specialized stakeholder groups (subgroups) within the ESAs to deal with specific matters. We think that the current composition of the ESAs' stakeholder group is too broad to ensure the relevant expertise on technically complex matters. In addition, ESAs should also become more transparent on the selection of the relevant stakeholders for these different groups.

Another way to enhance stakeholder engagement could be to appoint stakeholder group members as *ad hoc* observers to the ESAs Board of Supervisors.

² This was one of the options in the European Commission *Green Paper on Audit Policy – Lessons from the Crisis* in 2010. Available here: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52010DC0561&from=EN>

Notwithstanding these proposed improvements, it is important to improve practices in stakeholder engagement in order to take advantage of the real added value that it can bring to the policy setting process. ESAs should see stakeholders as partners and establish open channels of communication beyond what is required by legislation, in order to develop a true culture of stakeholder involvement.

Accountancy Europe has been contributing to the work of all the three ESAs and is actively engaged in the policy process in the EU as a whole. Nevertheless, experience so far has shown that there is insufficient involvement of stakeholders in the relevant groups of the ESAs.

In order to achieve better regulation objectives and take advantage of stakeholder consultation in a consistent way across the ESAs work areas, best practices in this respect, such as pre consultations with relevant stakeholders and informal meetings, should be shared and promoted, for instance through the Joint Committee.

Stakeholders groups are an important part of the policy process of the ESAs but are not the only way to get valuable input from civil society.

SUPERVISORY ARCHITECTURE AND FUNDING

We support the idea of looking into further ways to improve the ways ESAs work and to find synergies in their functioning.

However, the European Commission needs to proceed with a thorough analysis of the pros and cons of the available models of supervision (sectorial approach, “twin-peaks” or a single unified authority) before taking any decisions. Experiences at national level could provide a good basis for that and results could be part of an impact assessment or a comparative analysis.

Pros and cons of each model could be based on the following fundamental pillars:

- Efficiency and effectiveness;
- Need for competences/expertise/quality/resources;
- Link with market reality;
- Transparency of information flow.

Regardless of the structure, sectoral expertise should be preserved – detailed technical knowledge and expertise are key to sound financial supervision. For instance, despite some similarities, there are significant differences between the banking and the insurance sector (e.g. systemic nature of the banking sector) and will often require different approaches.

Furthermore, the option for a new model would certainly impact the funding of the ESAs and therefore should be duly considered in the impact assessment mentioned above, raising important questions regarding budget decision and monitoring.

In any case, a change in the current funding system should avoid any kind of “double contributions” from market participants to NCAs and to ESAs, and reflect how this will impact the funding of the former.



We remain committed to contribute to a constructive debate around financial regulation and supervision as well as to further integration in capital markets in the EU.

Sincerely,

A handwritten signature in blue ink, appearing to read "Edelfried Schneider".

Edelfried Schneider
President

A handwritten signature in blue ink, appearing to read "Olivier Boutellis-Taft".

Olivier Boutellis-Taft
Chief Executive