

ICMA Asset Management and Investors' Council (AMIC) feedback on proposal for a review of the European Supervisory Agencies (ESAs) and the European Systemic Risk Board (ESRB)

Introductory comments

The ICMA's Asset Management and Investors Council (AMIC) was established in March 2008 to represent the buy-side members of the ICMA membership. ICMA is one of the few trade associations with a European focus having both buy-side and sell-side representation. Our investor members represented by the AMIC would like to take this opportunity to comment regarding the proposals by the European Commission to reform the European Supervisory Agencies (ESAs) and the European Systemic Risk Board (ESRB).

AMIC members already contributed to the May 2017 [ICMA response](#) to the consultation by the European Commission. Many of our viewpoints in this document are based on the original work carried out by ICMA in responding to that earlier official consultation. This feedback also complements the work done by the ICMA primary market constituency in their [response](#) to the specific part of the proposal concerning prospectuses.

AMIC members would like to take the opportunity to welcome many of the very positive aspects of the proposals. ICMA and AMIC are strong supporters of Capital Markets Union (CMU) and we welcome proposals which will help to deliver better functioning capital markets for investors:

- **Supervisory convergence:** It is helpful that the concept of a single supervisory handbook is extended from the EBA to ESMA and EIOPA. ESMA and EIOPA can play an important role in further promoting regulatory convergence on the same basis that EBA has done in banking.
- **ESG factors:** As responsible investors we agree with the proposal to require the ESAs to consider ESG factors and to provide guidance on how firms can consider sustainability in their investment decisions.
- **Guidance and recommendations:** We strongly support the requirement to carry out cost-benefit analyses for new guidance and recommendations. Guidance and recommendations play an increasingly important role in the single rulebook process in Europe.
- **Third country equivalence:** It is helpful that the ESAs' expertise can be harnessed to improve equivalence deliberations by the European Commission.
- **Collection of information:** Investors strongly support greater centralisation of data in ESMA, which we will build on in our comments below.

Nevertheless, AMIC members have some significant concerns with several elements of the text, which we believe will not serve the best interests of end-investors in Europe. These proposals should be revisited if this framework is to be successful in increasing supervisory convergence and addressing the challenge of the UK leaving the EU. Our significant concerns, which we will lay out in greater detail below, are in the areas of:

- Direct supervision of funds;
- ESMA opinions on delegation arrangements;
- Funding arrangements;
- Consultations on Q&As; and
- Organisation of the ESRB.

In conclusion, the AMIC recognises the significance of these reforms. There are already many welcome elements in the proposals, but, as we have elaborated, we also consider that there is scope to significantly improve the overall package. We hope the Commission will take our views into account and would be pleased to discuss them at your convenience.

Direct supervision of funds

Introduction

While we agree with the general thrust of the proposals to increase supervisory convergence in Europe, the specific suggestion to move authorisation and supervision of certain EU fund structures (European Venture Capital funds (EuVeCa), European Social Entrepreneurship Funds (EuSEF), and European Long-Term Investment Funds (ELTIF)) to ESMA would lead to a more complex and expensive process.

Concerns with direct supervision

The current structure of fund authorisation and supervision in Europe is entirely based on national lines, with national competent authorities (NCAs) authorising and supervising funds. ESMA's role is limited to creating technical standards complementing EU legislation. We do not agree with the justification given by the Commission to move supervision and authorisation of these fund types to ESMA.

In Recitals 34 and 35 of the proposal, the Commission claims that national divergences create an unlevel playing field among managers, increasing costs and reducing investor choice. However, EuVeCas, EuSEFs and ELTIFs are based on the same European fund product structure as the far more widely used UCITS and AIF frameworks, i.e. a fund domiciled in one Member State can be marketed in other Member States (the "passport"). This fund structure has proven remarkably successful since the introduction of the UCITS framework in the 1980s. Considering there is no proof of market failures brought forward it is difficult to understand why this is now an unsuccessful model that requires a fundamental change in supervision of these funds, moving it to the European level.

Moving supervision of the three fund types to the ESMA level could risk disrupting the well-functioning EU model without sufficient justification for such a shift. NCAs are in a better position to carry out the day to day task of authorising and supervising funds. NCAs have the staff and expertise to do this job and have the local knowledge and language capability to interact with local fund providers. Furthermore, in the EU's passport-driven fund distribution model, funds tend to be domiciled in only a few jurisdictions, where local NCAs have developed a rigorous approach to fund authorisation and supervision.

As ICMA said in its May 2017 response, NCAs have an important role to play in the context of retail investor protection, which ESMA cannot well replicate centrally. ESMA lacks the resources to carry out the administratively onerous function of authorisation and supervision of the three proposed fund types. The foreseen staff increases (156 full time employees) is unlikely to cover such an increased direct supervisory burden. Instead, this change would impact the competitiveness of the EU funds industry, by creating a more complex, cumbersome and expensive authorisation process, without being of added value to end-investors.

Alternative – enhanced supervisory convergence

Instead of a disruptive shift in supervisory function from NCAs to ESMA, co-legislators should consider strengthening other aspects of ESMA’s work to increase supervisory convergence and streamline fund distribution.

The Commission’s on-going work in the CMU framework of reducing barriers to fund distribution is a very helpful starting point, particularly as it is a preferable approach to opening Level 1 provisions in UCITS and AIFMD. ESMA’s role in this process should be strengthened in order to help solve the practical issues asset managers face on a daily basis. Examples of how ESMA could be given a role includes (1) giving it a greater role in harmonising authorisation procedures, (2) highlighting positive and negative examples of practical cases of what constitutes “pre-marketing”, and (3) in challenging national barriers where they exist.

Existing authorisation and distribution processes where funds are to be sold on a cross-border basis could be streamlined by ESMA. This could cover initial notification and any subsequent amendment or update. A central register of such funds could be maintained by ESMA, provided the cost of this would not exceed the current cost of making existing Member State level notifications, along with some associated details, such as documentation and payment details.

ESMA as a data hub and consolidated tape provider

The role of ESMA in ensuring more uniform reporting should also be enhanced. If the EU legislators are interested in reducing costs and increasing investor choice, it would be more beneficial to eliminate reporting overlap across EU jurisdictions by allowing ESMA to play a greater role as a hub for data from NCAs. If ESMA instead becomes a direct supervisor of some funds, the reporting burden and overlaps are likely to increase, further increasing costs and reducing investor choice.

Instead, AMIC members would like to see ESMA considered as a potential candidate to provide a consolidated tape. ICMA has already made a case for ESMA providing this service in its [December 2016 response](#) to the ESMA Consultation Paper on RTS specifying the scope of the consolidated tape for non-equity financial instruments. As is evident, no commercial providers have emerged to provide a consolidated tape for non-equity instruments. The ESAs Review provides a helpful opportunity to revisit this debate and appoint ESMA to this role on the lines we have proposed.

Conclusion

We regret the focus in the proposals on direct supervision, when there is more to be gained through the ESA review by enhancing the ESA’s role in promoting supervisory convergence and delivering a single rulebook and harmonised data reporting.

ESA opinions on delegation arrangements

Delegation is one of the key pillars supporting the EU’s cross-border investment model which has made UCITS and increasingly AIFs, a global brand and a European success story. The Commission’s proposal would give the ESAs new powers to review delegation decisions made by firms to outsource, delegate or transfer a material part of risk outside the EU. Our concern relates to how

this proposal would affect in practice this established and well-functioning model for fund delegation in Europe.

The current fund distribution model in Europe, where assets are managed in local markets and funds are offered across borders, functions well. UCITS is a recognised global brand and a European success story. Together, UCITS and AIFs are recognised in over 75 jurisdictions worldwide including Asia and South America. These funds channel investment into Europe as well as across the rest of the world, funding corporate growth and job creation as well as enabling European savers to benefit from fund management expertise around the globe while enjoying the same level of investment protection as within the EU. UCITS have democratised investment and helped European citizens to invest and save for their retirements by diversifying their portfolios to increase returns and manage risk. Delegation is the key to be able to offer savers best-in-class global investment opportunities, wherever in the world they are located.

We understand the legitimate objective of the Commission to maintain strict quality standard and avoid letter-box entities, but we fear that the proposals to give ESMA powers to issue opinions and recommendations on delegation arrangements could undermine the delegation of functions to third country entities and therefore, possibly, endanger the existing successful model applicable to investment funds.

The delegation frameworks of UCITS and AIFMD are especially effective as they enable investment funds to delegate functions such as custody and portfolio management whilst being subject to strict control, oversight and accountability by those funds' national regulator in compliance with EU rules. Furthermore, the EU framework, specifically the AIFMD and [ESMA sectoral opinions on delegation](#), requires firms to meet certain conditions before they can delegate activities to ensure that they are not just 'letter-box' entities. The AIFMD has detailed rules in place governing the conditions applying when portfolio or risk management functions are delegated (Article 78 of Commission Delegated Regulation 231/2013) and criteria to avoid letter-box entity status (Article 82 of Commission Delegated Regulation 231/2013). These provisions of AIFMD were specifically introduced to avoid the risk of letter-box entities – which is also now the official aim of ESAs Review's Article 31a. Such delegation, as allowed by AIFMD, does not prevent NCAs from undertaking effective supervision and the asset management company is required to act in the best interests of the investors and to monitor the activities of the delegate effectively.

In addition, regarding the detail of the proposal in draft Article 31a, the notion of "material" creates a lot of uncertainty in its meaning and consequences from a delegation perspective.¹ The scope of the proposed ESAs' Review provision is not clearly defined and raises additional concerns among market participants.

Finally, giving a power to ESMA to publish recommendations to withdraw third country delegations already allowed by NCAs would lead to significant practical problems in the portfolio management of the relevant funds, if it should lead to the repeal of delegations already allowed. Ultimately, investors in the funds would pay the price.

¹ "... the outsourcing or delegation of a material part of its activities or any of the key functions or the risk transfer of a material part of its activities into third countries, to benefit from the EU passport while essentially performing substantial activities or functions outside the Union"

One less destabilising option would be to consider giving ESMA a role in coordinating the enforcement of the existing delegation requirements in AIFMD by being notified by NCAs when the NCAs allow third country delegations. This would already ensure a better monitoring of delegations and give an upgraded role to ESMA. It might also be worth considering extending the existing anti-letter box provisions of AIFMD to the UCITS Directive, to ensure that retail investors covered by the UCITS Directive are as well protected as non-retail investors covered by the AIFM Directive in the avoidance of letter-box entities.

An alternative option to consider would be for ESMA to focus on standardisation of the documentation and notification processes applied by NCAs using existing powers to drive supervisory convergence.

Funding

Although AMIC members are not in principle against contributing to the ESAs budgets, the way the proposals have been drafted would result in a very significantly increased cost burden for industry and ultimately all investors in UCITS and AIFs.

We consider it important in these proposals to keep a budgetary cap, as is achieved today in the 40/60 split between the EU budget and NCA contributions. Therefore, we support a fixed floor of 40% on the EU budget contribution, rather than a balancing maximum of 40% with no cap on the total.

The Commission's current proposals could otherwise open the door to a very significant increase in budgets and capability without sufficient oversight by budgetary contributors.

The Commission claims that the contributions to ESA budgets would be offset by reduced contributions to NCAs, but we disagree that this will be the case. It would help to have a mechanism that would ensure such an outcome. At least the total supervisory costs borne by the industry on a national as well as a European basis should be monitored and made transparent.

Consultations on Q&As

We welcome the Commission's proposal to extend systematic consultations to draft Guidelines by ESAs.

However, we think that consultations, either directly by ESAs or indirectly by NCAs, should also be carried out in the process of elaboration of draft Q&As. We believe that, given the often significant operational and commercial effect of the Q&As, there needs to be more effective industry consultation on Q&A.

While we recognise that ESMA may need to issue Q&A quickly, regular publication of the Q&A ESMA are considering would help give industry the opportunity to submit comments on the potential impact of changes. This could be a valuable way of obtaining relevant stakeholder feedback on the important issues Q&As tackle.

In addition, the legal status of Q&As should be clarified, as currently some NCAs consider them binding, while other NCAs consider Q&As as non-binding. This creates an unsatisfactory lack of a level playing field among market participants in Europe.

Organisation of the ESRB

In a separate legislative proposal, the Commission is also suggesting changes to the ESRB. AMIC members have already laid out, in October 2016, in [views on the organisation of macro-prudential policy framework](#), our specific comments on the organisation of the ESRB.

We noted then that in the current governance of the ESRB:

- half of the ESRB Steering Committee members are representing the ECB and national central banks; and
- among the 38 voting members of the ESRB General Board, 30 members are representatives of the ECB and national central banks.

Also, in the staffing of the ESRB there is no equal balance between banking experts, securities experts and insurance experts, therefore not ensuring an equal balance in experience and expertise between the three areas. The necessary sector-specific expertise is of utmost importance.

We are very concerned that in the published proposal there are no efforts to redress the balance between banking supervisors and securities supervisors in the ESRB. While the official role of ESRB is at the macro level, this level also covers risks in securities markets, so the banking concentration in the ESRB is very inconsistent from securities markets actors' perspective.

The Commission's proposal entrenches the domination of the ESRB by central banks. Market supervisors continue to be unfairly represented at the highest decision making-levels only by the single ESMA Chairperson. The proposals this fail to broaden the ESRB's structure beyond banking, to give it a better understanding of risk in financial markets. The ESRB Review represents an opportunity to correct this unjustified balance in the ESRB, which we hope can be addressed in the legislative process.

Finally, we advocate that the ESRB should always be required to conduct public stakeholder consultations on important recommendations (and not just "where appropriate").

ENDS