Deutsches Aktieninstitut

European Supervisory Authorities review takes the wrong track – Issues that should be addressed instead of granting ESMA new powers

The real issues are rebalancing level 1 and level 2 as well as improving accountability

Deutsches Aktieninstitut's response to the proposal of the European Commission on the operations of the European Supervisory Authorities, COM(2017) 536 final, 20 February 2018.

Executive summary

Deutsches Aktieninstitut deems the review of the existing EU supervisory framework as important in order to ensure both that European Supervisory Authorities (ESAs) work efficiently and can be held accountable for their actions.

The EU Commission's proposal on the review of the EU supervisory framework however fails to improve the accountability of ESAs' activities. Instead, too much emphasis is put on enhancing regulatory and supervisory convergence in Europe by granting ESAs additional powers. Especially with regard to ESMA, we note the political intention to increase its power substantially. This is- inter alia- done by the conferral of vaguely formulated competencies, pushing the door open for the assumption of even larger competencies in the future.

Deutsches Aktieninstitut is of the opinion that:

1. Until now, no concrete evidence has been presented that the existing instruments of ensuring convergence have significant deficits. In those cases where differences in national application of EU law occurred, this is either rooted in the fact, that most of the regulation has been enacted rather recently so that the relevant instruments have not yet had enough time to work or it is rooted in a lack of clarity of the level 1 texts which forces national supervisors to take some kind of interpretation in order to form a supervisory practice and ensure some legal certainty in due time. However, both does not justify more centralization of supervisory competences in the EU.

2. There are valid reasons why the current EU supervisory structure respects national particularities by referring to National Competent Authorities (NCAs) which are largely involved in the supervision of EU Financial Markets regulation: NCAs are closer to the national markets, they are better placed to know their specificities. At the same time, the current regime ensures an adequate level of harmonization. Those established and efficient structures must not be destroyed (as would be the case, e.g., if the competence for the approval of wholesale prospectuses were transferred to ESMA).

3. Therefore, Deutsches Aktieninstitut opposes the shifting of powers from NCAs to ESAs at least at this point in time-, especially with regard to ESMA. This also against the background that- once granted- they are unlikely to be repealed.

4. Much of the critique on the current supervisory system is instead rooted in overly complex and detailed level 2-regulations which itself is a consequence of a vague and too general wording on level 1. Rather than granting extensive new powers to ESAs, Deutsches Aktieninstitut believes that the ESA review should focus much more on ensuring an appropriate balance between level 1 and level 2: crucial political decisions should be taken by the legislator instead of being delegated to ESAs as it has occurred in the past.

5. Furthermore, improvements need to be made when it comes to holding ESAs accountable for their actions- as ESAs have repeatedly overstepped its powers in the past. Level 2 and 3 measures need to be better controlled if they are consistent with the political will of level 1.

6. Changing the funding of ESAs would cause significant difficulties and a change of the current ESAs funding model to a system fully funded by the NCAs or by involving the private sector is to be rejected in any case. The current funding structure has worked well in the past.

1 General remarks[1]

1.1 Importance of role of national competent authorities in European financial markets supervision

According to the EU Commission's proposal, there remains significant potential to enhance regulatory and supervisory convergence in the internal market.[2] To further improve supervisory convergence in Europe, especially ESMA is being granted extensive additional competences.

Deutsches Aktieninstitut is of the view that the EU Commission has not yet presented concrete evidence that the existing tools of ensuring convergence have significant deficits that would justify the proposed far-reaching shift of competences from NCAs to ESMA. In cases, where differences in the application of EU Financial Market rules in Member States occurred, the cause has not been a lack of ESMA's competences. In most cases the reason has been that the bulk of the regulation has been enacted rather recently so that the relevant instruments have not yet had enough time to work. Or the reason has been a lack of clarity of the level 1 texts which forces national supervisors to take some kind of interpretation in order to form a supervisory practice and ensure some legal certainty in due time, see in detail explained under 1.2.1.

Also, the importance of the role of NCAs in the supervision of EU Financial Markets Regulation should not be underestimated: NCAs are closer to the national markets, they are better placed to know their specificities. It should also not be underestimated that language barriers can still play an important role when it comes to interactions between the supervisor and market participants.

Therefore, we oppose the far-reaching allocation of new competencies to ESAs as set out in the EU Commission proposal.

1.2 Crucial issues to be addressed for improving the functioning of the ESAs

Rather than granting extensive new powers to ESAs, Deutsches Aktieninstitut believes that the EU Commission's proposal should have focused much more on

1 Please note that comments made in this paper relate exclusively to ESMA s` work, if not indicated otherwise, since the members of Deutsches Aktieninstitut are primarily affected by ESMA`s activities.
2 See EU Commission proposal COM(2017) 536 final, explanatory memorandum, page 2.

ensuring an appropriate balance between level 1 and level 2. Secondly, the governance and accountability of ESAs' activities need to be improved.

1.2.1 Appropriate balance between level 1 and level 2

From our perspective, the major problem concerning the operations of the ESAs lays mainly in a lack of appropriate balance between level 1 and level 2 legislation: More and more level 1 financial legislation tend to delegate important issues to level 2 which actually should to be tackled on level 1.

Legislative bodies of the EU, however, should ensure that all crucial political issues of the respective dossier at hand are being negotiated on level 1. Otherwise, level 1 leaves too much room for interpretation thereby creating a situation where ESAs mandate to only supplement the level 1 text becomes blurred. There are cases, where this has resulted in an extremely wide interpretation of the unclear terms contained in the level 1 text by the ESAs.[3]

ESMA's interpretations may lead to impracticable results for companies affected, which is possible because the level 1 text lacks precision. Therefore, Deutsches Aktieninstitut stresses the importance that the delegation of power must be clear, precise and detailed and should only aim to supplement certain non-substantive elements of the legislative act.

1.2.2 Governance and accountability aspects

The past has shown that ESAs have on several occasions overstepped the mandate conferred to them on level 1[4]. This has led to over-detailed rules or rules running counter the legislator's will on level 1. In many cases this led to disadvantages for market participants who were obliged to comply with the new set of rules drafted by ESMA. Governance and accountability aspects should thus not be neglected in the ESA review.

Importance should especially be given to enhance scrutiny of ESAs' activities by the European Parliament and the Council in order to bring the results of ESAs' work better in line with the legislator's will. The European Institutions ultimately assume

3 We have observed this e.g. in the context of the wide interpretation of the term "transaction" by ESMA under the implementation process of the Market Abuse Regulation.

4 One example can be seen in ESMA technical regulatory standards on MiFID II: Regarding commission-based distribution services, the EU legislator's decision in the Level 1-MiFID II-text was to allow the co-existence of commission-based distribution alongside the independent advice based on adequate information about the nature of the distribution channel. However, the list of negative criteria tabled by ESMA in order to assess the legitimacy of inducements would have led to an effective ban of the commission-based distribution services in Europe. This outcome clearly conflicted with the Level 1-text.

political responsibility for ESMAs' activities. The European Institutions will however only be able to live up to their political responsibility if they are provided with adequate tools to thoroughly scrutinize ESMA's activities.

2 Comments on EU Commission's proposed conferral of additional powers to ESMA

2.1 Supervisory handbook[5]

According to the plans of the European Commission, ESMA shall be authorized to draft a "Supervisory Handbook" with best practice proposals for the supervision of financial market participants within the EU.

Deutsches Aktieninstitut doesn't regard the introduction of a "Supervisory Handbook" necessary, since regular coordination between ESMA and the NCAs as well as the issuance of Q&As already today provide sufficient guidance for the supervision of financial market participants. Hence, we deem the introduction as redundant to existing tools which are already at ESMA's disposal.

Even more, with the introduction of the "Supervisory Handbook" we fear over-detailed "one size fits all" guidance, leaving little room for individual or national specifics. This might have a negative impact on market participants, which should be avoided.

2.2 Consumer and investor protection[6]

According to the EU Commission's proposal, ESAs shall contribute "to foster consumer and investor protection". The proposed vague wording doesn't add any specific new competences and is therefore redundant to already existing powers. The broad wording could however be used to gradually enlarge competences.

From Deutsches Aktieninstitut's point of view, the current powers of ESMA with respect to consumer and investor protection are already sufficient.

It is and should remain the task of National Competent Authorities to ensure that the EU legislation with respect to consumer and investor protection is properly applied bearing in mind the national specifics of financial markets and market participants. In addition, NCAs also have sufficient powers to take action against individual entities in breach of Union law with widely harmonized supervisory measures and sanctions that can be imposed.

More competences for ESMA would also result in an unclear separation of tasks between ESMA and NCAs as well as in double supervision and, thus, bears the risk

5 Article 3 paragraph 5, page 108 of the proposal
6 Article 3 paragraph 5, page 108 of the proposal

of additional bureaucracy. The proposed amendment should therefore be abolished.

On this occasion, we would like to remind that ESMA's tasks are first and foremost to strengthen capital markets and to ensure financial stability in Europe. Additional tasks, such as consumer protection, do not – though being important – pertain to the duties for which ESMA has been established.

2.3 Accounting[7]

The proposal stipulates the Accounting Directive 2013/34 to be within the scope of ESMA activities (see Article 3 (1) (a) on changes of Article 1 (2) of Regulation (EU) No. 1095/2010 (ESMA Regulation)). The proposal remains unclear as to which concrete activities shall be assigned to ESMA that make the reference to the Accounting Directive 2013/34 necessary. The same applies to the reference made in Article 3 (1) (a) to Regulation (EC) No 1606/2002 on the application of international accounting standards.

Already in the consultation prior to the proposal, the expansion of ESMA's competences in the areas of accounting and auditing had been put forward for discussion. According to the feedback statement of the EU Commission following the consultation, an expansion was largely rejected by many industry representatives.[8]

We, therefore, reiterate that from our point of view, there is no need to equip ESMA with additional powers with respect to accounting, auditing and enforcement of financial reports beyond the status quo. This holds especially true for both the endorsement of the IFRS and the enforcement of financial reporting. Regarding the latter Member States have – based on their legal traditions and their market specifics – developed different models ensuring that listed companies comply with the rules and auditors perform their tasks in a proper manner.

European companies already now take financial reporting very seriously. There is no evidence of major compliance deficits or significant potential misinformation of the public. Investors of European listed companies financials' can already be sure that the companies are transparent as the reliability of accounts is ensured by various institutional settings. There is even less evidence that a potential deficit needs to be tackled at European level.

7 Article 3 paragraph 1 (a), see page 107 of the proposal
8 Feedback statement on the public consultation on the operations of the European Supervisory Authorities, https://ec.europa.eu/info/sites/info/files/2017-esas-operations-summary-of-responses_en.pdf, page 11.

2.4 Environmental, social and governance factors[9]

According to Article 8 paragraph 1a (new), ESAs shall "take account of technological innovation, innovative and sustainable business models, and the integration of environmental, social and governance related factors."

As such factors have to be reported already now by market participants under the respective legislative act, the proposed competence is redundant. In case the amendment is meant to provide guidance for the legislator, such guidance can already today be given via technical advice.

In any case, it should be avoided that the amendment is interpreted as a competence for ESAs to launch initiatives in the field of sustainable finance as such a right exclusively lies with the legislator. We therefore recommend deleting the respective amendment.

2.5 Collection of information[10]

According to the newly introduced paragraph 2 of Article 17, "….the Authority may address a duly justified and reasoned request for information directly to other competent authorities or relevant financial market participants, whenever deemed necessary for the purpose of investigating an alleged breach or non-application of Union law."[11]

Deutsches Aktieninstitut considers it critical to grant ESMA such far-reaching powers, as they would not be proportionate: such a right is generally only granted to the competent authority having direct supervisory powers over the respective market participant.

There is furthermore the danger that the right for seeking information from market participants, even if only subsidiary, becomes the rule in practice. In that case, competences of NCAs regarding their right for seeking information become blurred.

For the same reason we are critical for the information request rights to market participants under Articles 35a to 35 h (new) (see Article 3 (21)). It even contains in Article 35 d the possibility to fine market participants with up to 200,000 Euro for not following an ESAs' information request. Such far-reaching rights should be limited to cases of direct supervision, because of the above mentioned arguments.

In this context, it should be emphasized that ESMA's competence to request information from and take enforcement action against individual companies needs

9 Article 3 paragraph 5, inserting Article 8 paragraph 1a (new), page 108 of the proposal
10 Article 3 paragraphs 8 and 21, pages 109 and 118 of the proposal
11 See Article 3 paragraph 8 of the proposal

to respect the limits set by the European Court of Justice (ECJ) in its judgment C-270/12 where it ruled on ESMA's ability to prohibit short sales pursuant to Article 28 Regulation 236/2012 on short sales and credit default swaps. In this judgment, the ECJ emphasized that ESMA's competence to prohibit the entry by legal persons into short sale transactions was only permissible to the extent that such action was necessary to defend financial stability and preserve the financial system, i.e. under extraordinary circumstances. It is also worth mentioning that the Advocat General had concluded that Article 28 Regulation 236/2012 was not covered by Article 114 TFEU anymore. The Advocate General viewed ESMA's competence pursuant to Article 28 not as a measure to harmonize the internal market – which would have been necessary to be based on Article 114 TFEU – but as a transfer of competency from national competent authorities to ESMA, which should have been based on Article 352 TFEU. Given that the competencies in favour of ESMA provided for in Article 35-35h would include any information that enables ESMA to carry out its duties, it appears that this would not meet the standard established by the ECJ; further, it would also amount to a transfer of competencies from the national competent authorities to ESMA in a form that the Advocate General considered excessive.

2.6 Market Abuse[12]

According to the EU Commission proposal, a coordinating role towards national supervisory authorities shall be assigned to ESMA in relation to orders, transactions or activities with significant cross-border effect that have the potential to threaten the proper functioning of financial markets and the financial stability in the EU.

For this purpose, ESMA shall be allowed to set up a data collection point (see Article 3 (16) for the insertion of a new Article 31b in Regulation (EU) No. 1095/2010 (ESMA Regulation)). According to the explanation of the EU Commission proposal, this competence is of significant importance in the context of market abuse (see page 21 of the Commission proposal).

Whilst seeing the merit of a centralized data point to fight cross-border market manipulation, the necessity of such a competence is not clear to us.

Articles 24, 25 Regulation (EU) No 596/2014 on market abuse (Market Abuse Regulation) already provide far-reaching obligations for NCAs within the EU to cooperate with each other as well as with ESMA. In addition, the proposal contains a large number of vague legal terms without giving typical examples. Hence, it is unclear which competences shall ultimately be assigned to ESMA compared to the ones being granted to NCAs and compared to the status quo.

12 Article 3 paragraph 16, page 116 of the proposal

Clarification is therefore needed.

2.7 Peer review[13]

The EU Commission proposes that in the future, peer reviews shall fall within the responsibility of the new Executive Board to be established by each ESA.

For issuers it is less important which body performs the peer review but rather that supervised market participants are involved appropriately in order to ensure that their point of view is properly reflected.

For the review process to work efficiently, we would therefore appreciate if ESAs were obliged to solicit comments of stakeholders when drafting EU peer reviews in order to have other case-specific input than those coming from the reviewed authorities themselves. The ESMA Principles on stakeholder engagement in peer reviews point into the right direction, but need to be strengthened and improved. They leave too much discretion to the NCAs regarding the participation of stakeholders to ESAs activities. It seems to us that a NCA can de facto veto the participation of stakeholders.

We further would like to express our concerns regarding the peer review of guidelines and recommendations in accordance with Article 30 no. 2(b). Guidelines and recommendations are not legally binding by definition and therefore they are not enforceable.

We believe it would be more appropriate to limit the scope of peer reviews to the breach of Union law, which include regulatory technical standards and implementing technical standards but not to guidelines and recommendations.

2.8 Prospectus[14]

The proposal is to transfer the approval and the advertisement powers of certain prospectuses under the Prospectus Regulation from NCAs to ESMA. This, inter alia, relates to prospectuses for wholesale non-equity securities (wholesale prospectus). We have significant concerns regarding this transfer of competences.

The plan to focus on wholesale prospectuses feels unsuitable. By definition wholesale prospectuses target qualified professional investors only. If the European Commission would indeed be of the opinion that a transfer of wholesale oversight would enhance consumer and investor protection than it is unreasonable that the

13 Article 3 paragraph 13, page 113 of the proposal
14 Article 9, amending Regulation (EU) 2017/1129, page 235 of the proposal

much weaker group of retail investors is carved out and left with less comfort relative to market professionals.

When drawing up a base prospectus it is a normal procedure to incorporate certain documents like financial statements, articles, certificate of incorporation by reference. Depending on the country of origin the language of these documents might because of local laws and regulations differ from that of the prospectus. This fact proofs to be an issue since different NCA would each accept a different set of languages. At present issuers are free to choose where to seek approval for a wholesale prospectus. Since it is most efficient this choice will be strongly influenced by the question to what degree languages of need are accepted by the NCA in a particular place. Such problem is most pronounced for multi issuer programs. Still more general we see the risk that an additional burden of translation works like a non-tariff-barrier and could hold potential issuers from using the capital market as source of funding.

The variety of language regimes which exists among NCA is a very good example how efficient the current system of multiple NCA is for the market development in Europa. Specialization, excellence in a particular filed and burden sharing in oversight is a strength of the European capital market which should be persevered. We mustn't forget, that the competition to attract capital is global. The ability to respond timely and flexible to market participant needs is in the end a decisive factor when it comes to fund investments and to create jobs in Europe.

Not least because of better fitting language regimes a few Member States have emerged as centers for the approval of wholesale prospectuses, where national regulators are highly experienced in this. Important structures, know-how and efficiency have been formed at these locations. The existing certainty and predictability of the approval process, speed of procedures and cost efficiency is very important for the professional market. Even with great effort, it seems very doubtful that ESMA can fulfill these requirements even in the medium term. In light of the upcoming challenges, such as United Kingdom's exit from the Union (Brexit), it is important to build on established structures instead of creating additional disruptions and risks.

In addition, the approval competence of ESMA in this context would trigger inefficiencies in supervision and unnecessary burdens for issuers and the respective NCA: for example, under current practice, a prospectus is often used for both retail and wholesale. In such cases, a subsequently used prospectus for retail investors would result in a new approval procedure at NCA level. This means unnecessary burdens on both sides and inefficient supervision. More problems with double supervision arise when supplements have to be made.

Effective supervision is ensured if it is conducted closely in the respective markets and takes into account the specific national market conditions. It should be noted

that the vast majority of new issuances are only available in one or a few Member States. Here, a prospectus check by the NCAs is more appropriate as they know the specifics of their national market and the market participants. This also allows the NCAs to react quickly and appropriately to changes. Therefore, it does not make sense to create completely new structures and additional resources at ESMA in these areas, as supervisory convergence is already ensured with the existing instruments (such as the implementation of peer reviews and the adoption of guidelines). As a result, potential regulatory arbitrage is already effectively countered. In addition, the harmonization of new regulations also takes time, so that market-specific features can be taken into account sufficiently.

Therefore, we do not see any necessity nor added value to grant ESMA the competencies mentioned above. Rather, we do fear negative consequences, if those competences were conferred to ESMA.

3 Accountability and governance

In the past few years, members of Deutsches Aktieninstitut have made the experience that on several occasions acts stemming from ESMA have gone beyond the text adopted on level 1 or contained extremely wide interpretations. This either led to over-detailed rules or even counteracted he legislator's will set out on level 1. [15]

We therefore deem improvements of accountability and governance aspects necessary in order to better control the outcome of ESMA's work. Unfortunately, the proposal has not given accountability and governance aspects the attention needed.

3.1 Accountability aspects

Importance should be given to enhance scrutiny of ESAs' activities by the European Commission, the European Parliament and the Council.

The options that need to be considered are:

3.1.1 Extend deadline for the EU Parliament and the Council to object Regulatory Technical Standards (RTS)

Whenever the EU Commission adopts RTS without changes to the one submitted by the Authority, the period during which the European Parliament and the Council may object is reduced to one month from the date of notification by the EU Commission. At the initiative of the European Parliament or the Council that period should be extended to two months.

Bearing in mind the limited resources available to Members of the European Parliament and smaller Member States as well as the complexity of most of the drafts the standard endorsement period of one month for the co-legislators appears too short. The Parliament and the Council should be given more time to consider the draft RTS, even if the EU Commission sees no need to change them. This would ensure that the political will is incorporated in the delegated measures, in particular where the level 1 texts leave room for interpretation.

15 Examples can be identified following measures by ESMA on the Market Abuse Regulation (e.g the extremely wide interpreation of mangagers' transactions), the Transparency Directive (e.g. the latestet proposal on the ESEF) or within EMIR (e.g. the very detailed data fields).

3.1.2 Clarify criteria determining deadlines for objection to RTS

In addition, there is the threat that the Commission considers the RTS as being "the same" as in the draft RTS submitted by the ESA, even though they had been changed in a way that goes beyond pure linguistic corrections and amounts instead to a substantial change.

In our view, criteria according to which deadlines for objection to RTS are set out and/or extended need to be clarified, i.e. in which cases can it be considered that draft and final RTS are not "the same" and the three months deadline for objection applies. Lastly, the EU Commission should be required to provide, on request, clarifications about changes made to the draft RTS in case there are doubts about their non-substantial nature.

3.1.3 Participation of the European Parliament and the Council already in the drafting phase

Regular informal exchange between the EU Institutions and the ESAs – e.g. as established between ESMA and the ECON-committee of the European Parliament since 2012 – is deemed useful. The review might probe the idea of ESAs forwarding preliminary versions of draft regulatory technical standards, working documents or non-papers to at least the rapporteur on the file in the Parliament and the chair of the working group of the respective Council Presidency before they are approved by the Board of Supervisors (BoS). Such an approach would help the EU institutions to better follow the discussions and would speed up the process in case of sensitive issues.

3.2 Stakeholder engagement

Despite the changes proposed by the EU Commission, which we welcome, we still see room for further improvement: decisions should be based on the broadest possible input. It is of utmost importance that especially issuers having to deal with day-to-day compliance of capital markets regulation are given the opportunity to provide ESMA with feedback.

Deutsches Aktieninstitut has the following recommendations

3.2.1 Consultations:

We think that it would make sense to launch consultations on draft regulatory technical standards after they have been submitted to the EU Commission on the initiative of one of the co-legislators: as the co-legislators have the right to scrutinize the standards it might be deemed important to receive feedback from stakeholders. Like this, the co-legislators would be better prepared to assess the impact the standards will have on the market.

3.2.2 Better engagement of ESMA with stakeholders:

As regard to the ESMA consultative working groups (CWG) it is our experience that there is not sufficient transparency regarding the group meetings: It is emphasised that documentation is strictly confidential, meaning it cannot be shared with anyone outside the CWG, and that the CWG members have been appointed in their personal capacity and therefore should not discuss the proposals with outsiders or within the trade associations. Those deficiencies should be remedied, because it should be in the interest of the ESAs that there is a broad informal debate on certain critical provisions before the formal consultation process or during the phase of drafting regulatory standards.

3.2.3 More balanced representation of interests is needed:

We call for a balanced representation of stakeholders: while in recent years' investors and financial services consumers have become overrepresented in ESMA stakeholder and consultative WGs, there is often a lack of representation of non-financial companies.

3.3 Guidelines and Q&As

3.3.1 ESMA guidelines

Although guidelines are legally not binding, the past has shown that they cannot and will not simply be ignored by National Competent Authorities nor by the supervised entities. As a consequence, they have de facto binding effects and therefore a significant impact on market participants.

Against this background, the ESAs regulations should be altered in some respects to ensure that guidelines cannot be used for standard stetting "through the back door" without a clear legal mandate on level 1, as we have for example seen in the efforts of EBA to erase the corporate exemption to CVA in CRD IV.

- First, the competence to issue guidelines should be stated in a less general manner, so that ESAs make restrained use of guidelines and, if they are issued, take a rather principle based approach. Also, Article 16 of the ESA regulation does not only mention the purpose to establish consistent, but also efficient and effective supervisory practices. In this context, it should also be taken into account that national specifics still exist and therefore some flexibility is required in order to allow for an efficient and effective supervisory practice. Too many and too detailed guidelines and recommendations bear the risk that national authorities and market participants will face difficulties to comply with them in practice. We would therefore prefer that guidelines are issued only on the basis of clear mandate within the level 1-regulation.

- Second, to prevent/remedy potential discrepancies in the implementation of EU legislation in the various Member States that are harmful for European Capital Markets, we suggest ESMA collects information on differences that occurred- rather than issuing guidelines. The compilation could be published subsequently in order to increase transparency on interpretations that have disrupted the markets which in turn will likely help National Competent Authorities to refrain from such interpretations in the implementation process of EU legislation. This would not require any additional competences for ESMA and would at the same time be more appropriate for market participants. It would help to focus on the most relevant individual cases instead of NCAs and market participants having to cope with extensive guidelines that might not take into consideration national market specifics.

- Third, greater stakeholder engagement needs to be guaranteed. We are pleased to see the EU Commission's proposal that ESAs shall conduct open public consultations regarding the guidelines and recommendations and that the related potential costs and benefits of issuing such guidelines and recommendations shall be analyzed. It is also welcome that the Authority shall, save in exceptional circumstances, also request opinions or advice from the Securities and Markets Stakeholder Group.

Also, the possibility for the Securities and Markets Stakeholder Group to send a reasoned opinion to the Commission if members are convinced that certain guidelines or recommendations exceed the competence of the Authority, points in the right direction. Nevertheless, we deem the requirement of two thirds of the members of the Securities and Markets Stakeholder Group as too high, given the quite diverse backgrounds of its members. A simple majority would therefore be preferable.

3.3.2 Q&As

Besides guidelines, we would also like to address the issue of Q&As, which are largely used by ESAs to provide assistance in the interpretation of the level 1 and level 2 text.

Deutsches Aktieninstitut demands that Q&As are issued cautiously and on a principle based approach, for the same reasons as guidelines (see above).[16]

Furthermore, we would like to point to the following improvements regarding the Q&A process which should be considered in the ESA review:

16 E.g. under EMIR, market participants faced huge administrative burdens to implement the respective compliance processes due to frequent updates of the ESMA Q&As. The same problem arised recently under MiFID II/MiFIR.

- Improvements regarding market consultation should be made having in mind that the Q&A – though non-binding – will have an impact on the behavior of market participants. Currently, market participants have no possibility to comment on the ESMA Q&As with regard to their practical feasibility.

- In the same vein, it is problematic that the implementation periods for changes of the Q&As are not clearly defined. It is very challenging for market participants to apply the updates immediately, lacking other timing information. This should be remedied accordingly.

3.4 Better regulation agenda

Laws should be finalized well before their application and stakeholders should have the time to prepare for the new rules. Improvement is specifically needed regarding the timeline for the adoption of level 2 measures.

A perfect example in that respect it the entry of force of the Market Abuse Regulation. Here, the level 2 measures had to be applied from 3 July 2016, together with the main Regulation (MAR). However, out of 16 level 2 measures, 7 had only been published in June (2 of them on 30th and 29th June); 6 in April; 2 in March; 1 in December. Guidelines were published on 13 July. Therefore, companies did not have enough time to look at those measures and to put in place the appropriate arrangements.

Given severe obligations and serious consequences in case of non-compliance (including criminal sanctions with MAR provisions, the situation was particularly difficult. Thus, we think that the review should consider this kind of situations and possible solutions.

Our recommendations for improvements are:

- when level 1 calls for many level 2 measures, the legislator should provide for longer transition periods.

- a general provision in the ESMA regulation (or a specific provision at level 1) should state that level 2 measures must be published at least 6 months before the date of application of level 1.

- a general provision in the ESMA regulation obliging ESMA to notify the EU Commission in case ESMA is not able to deliver certain measures on time. Subsequently, the date of application of level 1 shall be automatically postponed.

4 Financing of ESAs

4.1 Retain EU budgetary contributions

Deutsches Aktieninstitut very much welcomes the EU Commission's proposal to maintain the principle that 40 % of the annual funding of the ESAs stem from the EU budget. We strongly oppose changing the current ESAs funding model to a system fully funded by the NCAs or the private sector.

The current model most importantly empowers the Budgetary Authority (European Parliament and Council) to exert budgetary control over the ESAs and thereby ensures that ESAs can be held accountable. Otherwise, there would be no democratic control. At present, better control and accountability of the ESAs would be needed (see above). The current funding model is an important tool to control the ESAs.

In case the contribution from the EU budget would be reduced or even eliminated, it would be necessary that

- the governing institutions take the political responsibility for the acts of ESAs as it is, e.g., the case with the German NCA (BaFin). Even though independent, BaFin nevertheless, is also part of the Federal administration. It is, hence, subject to the legal and technical oversight of the Federal Ministry of Finance, within the framework of which the legality and fitness for purpose of BaFin's administrative actions are being monitored.

- Furthermore, it would be necessary that "the industry" is part of a representative body. Each ESA would need to have a body which equally represents both the supervised companies and the governing institution. These bodies could monitor the management of the ESAs and support them in the performance of their supervisory functions. Furthermore, these bodies should be responsible for decisions over the budget of the respective ESA like an administrative council in Germany.

- Another point that must be considered is that a change would need time for implementation and would lead to very high introductory costs and, thus, increased administrative burdens and costs: National constitutions set high hurdles for the legitimacy of such special levy on private companies. For example, according to the German constitutional law, these contributions must be justified both by legal reason and by amount

of the contribution.[17] According to the jurisdiction of the German Federal Constitutional Court (BVerfG), companies may only be charged if they cause the supervisory activity or at least are the main beneficiaries from it .[18] The levy must also be documented in budgetary terms und regularly reviewed by the legislator.[19] In Germany, the contributions are basically allocated according to the principle of causation and in an activity-based costing structure in order to achieve legitimacy of the model (§§ 16 ff. FinDAG).[20] In practice, there are always difficulties, which is why it is necessary to constantly improve. The required transparency and the activity-based cost structure which takes into account the causation principle create huge administrative expenses because every single activity of the supervisory authority's staff has to be recorded and allocated to the relevant groups of supervised entities.

For all these reasons Deutsches Aktieninstitut strongly opposes to change the current ESAs funding model to a system fully funded by the NCAs or the private sector.

4.2 Issues regarding funding by the private sector (financial institutions)

Deutsches Aktieninstitut has serious misgivings about changing the current ESAs funding model to a system (partly) funded by the private sector in place of NCAs.

4.2.1 Importance of EU budgetary contribution and issues related thereto

First of all, we strongly reject any change regarding the contribution of the general EU Budget (40%) for the reasons stated above under No 1.

4.2.2 Distinction between financial and non-financial sector

Deutsches Aktieninstitut welcomes that the Commission distinguishes between financial and non-financial companies. In the further legislative process, it must be ensured by a clear wording that non-financial companies are not inadvertently drawn into the financing of the ESAs.

The mere circumstance that securities of non-financial companies are traded on capital markets does not turn non-financial companies into active market

17 Cf. BVerfG v. 03.02.2009 – 2 BvL 54/06, Rn. 104; BVerfG v. 28.01.2014 – 2 BvR 1561/12, Rn. 121; BVerwG v. 23.11.2011 – 8 C 20.10, Rn. 31 und 32 ff.
18 Cf. BVerfG v. 28.01.2014 – 2 BvR 1561/12, Rn. 121.
19 Cf. BVerfG v. 17.07.2003 – 2 BvL 1/99 u.a., Rn. 120 and at last for the BaFin-Levy BVerwG v. 23.11.2011 – 8 C 20.10, Rn. 27.
20 Compare also the official justification of the FinDAG - BT-Drs. 17/11119, S. 30.

participants.[21] They should, thus, not be required to contribute to the financing of the ESAs, whose task is first and foremost to regulate and supervise capital markets and those being considered as active market participants.

Non-financial companies are primarily affected by ESAs´ activities when it comes to issuer-related measures. Such matters only form a minor part of the ESAs´ activities and expenditure and, therefore, cannot be compared with those for really active market participants. Furthermore, the ESAs´ activities regarding non-financial companies clearly have the character of a public good which cannot be financed according to the causation principle. Consequently, it does not seem proportionate to burden the funding obligation on non-financial companies.

Moreover, requiring non-financial companies to contribute to the ESA budget would create an additional burden for non-financial companies who are already exposed to a significant amount of obligations under capital markets regulations. This contrasts with the European EU Commission´s agenda on the establishment of a Capital Markets Union, which is supposed to make capital markets more attractive for companies throughout Europe in order to foster investment and growth.

4.2.3 Governance consequences of a shift of funding to the financial sector

Furthermore, it would be necessary that the financial companies are part of a representative body of each ESA. The more the funding obligation is shifted to the financial companies the more the involvement and competences of the NCAs have to be shifted to the financial companies too (see, e.g., the administrative council of the German NCA explained above).

In addition, more transparency about the cost structure and cost allocation of the ESAs is needed. The higher the burden for financial companies, the higher need to be the requirements regarding transparency, cost structure and cost allocation of the funding model (see more above under 4.1, third bullet point).

4.3 Distribution regime

Deutsches Aktieninstitut recommends retaining the distribution key of the ESAs' funding model. There are no valid reasons for changing the current system.

21 See also reasoning of the U.S. Securities and Exchange Commission in the Securities Exchange Act, Section 31, https://www.sec.gov/divisions/marketreg/sec31feesbasicinfo.htm.

4.3.1 Current distribution

Deutsches Aktieninstitut opposes to change the distribution between the member states. The current distribution is easy to handle and does not incur significant costs.

4.3.2 Adequate criteria for the distribution

In order to allow distribution of the costs to the financial institutions the Commission would like to be empowered to determine how these contributions be calculated. The Commission, i.a., wants to establish "appropriate and objective criteria" to determine the annual contribution payable by individual financial institutions. As regards to the establishment of "appropriate and objective criteria" we stress that a few criteria do not seem appropriate to make funding more just. There is not only the size of a Member State's financial industry or the size/importance of sectors/entities to be taken into consideration. A small financial industry may require much more supervisory activities than a proven big one. Furthermore, the beneficiaries of a financial market may also be investors from other countries. There are so many criteria and all of them must be evaluated and put into relation.

A more proportionate division than the current cost distribution (which is measured by qualified majority voting rule of the Council) would be possible at most by a large number of various criteria and key figures which are very difficult to calculate. This would lead to considerable additional expenses and costs. A few criteria would only give the impression of a fairer financing, but would, in reality not be better. A fairer distribution would only be possible by taking into account the principle of causation. An example of this would be the financing of the German NCA (BaFin). But such a complex key has the disadvantage that it needs a lot of time, very high introductory costs and increased administrative burdens and costs for the ESAs (compare under No 1 c).

4.3.3 Consequences for the distribution of voting rights

The markets of the Member States and their companies vary in size and, from the point of view of the Commission, therefore also benefit differently from the EU regulations of the market and the indirect supervision of the ESAs. However, in the event of any changes in the distribution of costs among the NCAs (respectively their supervised companies), the voting rights of the NCAs in the ESAs must also be changed equivalently. Otherwise it would not be comprehensible, if those who are not or only slightly affected by the regulations of the market and indirect supervision by the ESAs can just as well determine as those most affected. Furthermore, the most affected NCAs have also more experience, resources and responsibility towards a single European financial market.

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