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Lord Boswell of Aynho
Chair
European Union Committee
Committee Office
House of Lords
London
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3rd April 2019

Dear Tim,

EMs 12420/17, 12422/17, 12430/17, 12431/17, 12433/17, 12111/18: European System of Financial Supervision Omnibus Proposal

European System of Financial Supervision (39052) (39053) (39055) (39056)

I am writing to update you on the progress of negotiations on the Commission's Review of the European System of Financial Supervision (ESFS), which reached political agreement on 21 March. Technical discussions concluded last week, and we expect the file to be adopted by Finance Minister's at the Economic and Financial Affairs Council (ECOFIN) next month.

The final compromise meets the UK's negotiating objectives as set out in our previous correspondence. A brief outline of the inter institutional agreement is as follows:

On the governance of the European Supervisory Authorities (ESAs), the Commission's proposal to create a new Executive Board has been rejected; instead the role and power of the Chairperson in the Management Board has been reformed. The appointment procedure of the Chairperson has also been amended to give the European Parliament (EP) a veto over the Council's final appointment decision. The Board of Supervisors (which consists of the heads of national competent authorities) will remain responsible for shortlisting candidates for the position of the chair, and will retain its role as the primary decision maker.

With regards to funding, the status quo has been retained, so the ESAs will continue to receive money partly from the EU budget and partly from competent authorities. The Commission's proposal to introduce direct industry funding has been deleted, however Council have accepted the Parliament's proposal to include a recital that will give the ESAs the option to review whether financial institutions supervised by the ESAs should make additional direct contributions.

In relation to supervisory convergence, the final compromise adopts Council's proposal to set up coordination groups. As I outlined in my letter in December, coordination groups are new informal platforms for competent authorities to exchange information and experience. They were

originally intended to replace the Commission's proposal to give the ESAs the power to approve and challenge firms plans for delegation and outsourcing (which has been deleted in full) but in practice they are much broader and are not specific to delegation and outsourcing. For example, the final compromise stipulates that coordination groups can cover anything within the remit of the ESAs competency and can only be created if there is a need for NCAs to coordinate in response to market developments. This is a very significant improvement over the original proposals which would have granted the ESAs veto powers over outsourcing and delegation to third countries. The ESAs current toolkit for promoting supervisory convergence (such as Q&As and Peer Reviews) has also been strengthened.

With regards to direct supervision, the compromise text does not transfer ESMA supervisory competence for prospectuses as the per the original Commission proposal. However, ESMA has been given competence for some critical benchmarks (our understanding is that in a scenario where the UK is bound by this regulation, LIBOR would remain under the competency of the FCA) and third country administrators of benchmarks. This compromise will create a simpler process for third country recognition applications by removing the complex member state of reference rules, and ESMA has not been given competence for third country endorsement applications, which was covered in the original proposal but would have led to dual supervision of firms.

ESMA has also been granted competence for large data reporting service providers (DRSPs) that are deemed to be of significance to the internal market. This moves away from the Council position which gave ESMA competence for consolidated tape providers instead of all DRSPs. However, the compromise reached is acceptable because national competent authorities will still have immediate access to the data required for market monitoring, as such data will have to be shared with both them and ESMA.

Council's position on the ESAs' role in the ongoing monitoring of third country equivalence has been adopted in full, with the addition of the EPs proposal for the ESAs annual report on equivalence to be shared with the EP and Council. This is a positive change as it will allow for a more transparent and predictable approach to the process.

The European Parliament's proposal to include a review clause for ESMA to assess the benefit of third country regimes for trading venues and central security depositories based on their significance once every three years, has been adopted in full. While this is not ideal (especially as it inaccurately implies that trading venues are globally systemic) it is preferable to the European Parliament's original proposal to introduce full third country regimes into the file. Furthermore, as the Commission have existing powers to undertake such review at any time, it is to some degree insubstantial.

An additional tool that has been given to the ESAs as part of the final compromise is 'no action letters'. This will enable to the ESAs to recommend forbearance to competent authorities and the Commission when market confidence, consumer protection, the orderly functioning of financial markets or the stability of the Union is at risk. Council worked closely with the Commission and Council Legal Services to ensure that any forbearance power is adequately framed so that the ESAs can only suggest to the COM when they think new legislation, including delegated or implementing acts, are needed. We are supportive of this addition as there are numerous precedents of ill-calibrated and unworkable Level 2 measures being adopted that have a negative effect on supervision and competition, and we believe the power is composed in such a way that

the ESAs will not be able to reform legislation unilaterally, which was a key concern in negotiations.

Finally, on the anti-money laundering (AML) part of the file, as Council and the Parliament's positions were relatively close going into the inter institutional negotiation, reaching agreement on this section was easier and less political than for the core proposal. Where there was divergence, the EP tended to move towards the Council's position, for example they agreed to adopt Council's proposal for the EBA to focus their efforts on collecting information about material weaknesses which will be defined in draft regulatory standards. They also accepted Council's proposal to set up an internal committee on AML, anti-money laundering. This will provide EIOPA and ESMA with a permanent platform to input into the EBA's work in preventing future cases of money laundering AML across the Union.

As negotiations have now finished, I would be grateful if you are able to release this file from scrutiny.

I am writing in similar terms to Sir William Cash, the Chair of the House of Commons European Scrutiny Committee; and copying this letter to Foeke Noppert, Clerk to the Commons Committee; Chris Johnson, Clerk to the Lords Committee; Matthew Manning, Clerk to the Lords Financial Affairs sub-Committee; Adam Whitehead, Department for Exiting the EU; Barbara Armstrong and Ian Howe, HM Treasury.

with very best regards



JOHN GLEN MP

ECONOMIC SECRETARY TO THE TREASURY

