



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Sir William Cash MP
Chair
European Scrutiny Committee
House of Commons
London
SW1A 0AA

Dear Sir Bill,

7th June 2018

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

Thank you for your report of 21 February on scrutiny of the omnibus proposal on the European System of Financial Supervision, following our letter of 31 January. I note that the proposal on the European Systemic Risk Board has been cleared from scrutiny, and the remaining documents are retained under scrutiny.

Update on Implementation Period

As requested, I am writing to you following implementation period (IP) negotiations to update you on the implications of the negotiations on the possibility of the UK being represented in the ESAs.

The Government has been clear that once the UK is a non-member state, the UK will no longer have the same role in the decision-making of the EU. However, it is clearly in the interests of both sides to work closely together on matters that concern us, as set out in the agreement.

The IP text that we agreed with the EU in March would enable UK participation in the ESAs during the IP. The relevant article in the legal text is 123(5). As you have stated in your letter, this article sets out that the UK may, upon invitation, exceptionally attend meetings or parts of meetings of agencies, provided that:

- (a) the discussion concerns individual acts to be addressed during the transition period to the United Kingdom or to natural or legal persons residing or established in the United Kingdom; or
- (b) the presence of the United Kingdom is necessary and in the interest of the Union, in particular for the effective implementation of Union law during the transition period.

The UK's presence at such meetings would be limited to agenda items fulfilling either of the conditions above, and the UK would not have voting rights.

The Government takes its international obligations to protect financial stability very seriously and we remain strongly supportive of continued engagement and cooperation between UK and EU regulators. To help ensure a smooth adjustment to the future relationship, the UK will continue to engage with and work alongside the ESAs during the Implementation Period. The exact nature of this engagement is a matter for further discussion with the European Commission. I will provide you with an update when further details are available.

European Central Bank Opinion

I would also like to take this opportunity to inform you that the European Central Bank (ECB) has published an Opinion and technical working document¹, dated 11 April 2018, on the ESFS omnibus proposal.

The ECB welcomes the review of the ESAs and supports the objective of promoting supervisory convergence. It notes that the Banking Union and Capital Markets Union are at different stages and therefore the outcome of the review should not necessarily be the same for all three ESAs.

On governance, the ECB thinks that the Board of Supervisors should remain the decision-making body for tasks relating to fostering supervisory convergence, but it sees a place for an Executive Board focussed on administrative tasks, on which the ECB should be granted observer status. The ECB thinks that the proposed Strategic Supervisory Plan would be inappropriate, as strategic planning powers should be carried out by the competent micro-prudential supervisory authority. Furthermore, planning and implementation of supervisory strategies and tasks should be carried out by the same authority to avoid inefficiencies or the EBA being responsible for supervisory planning for which the ECB is ultimately accountable. The ECB also highlights the impracticalities of the proposed strategic and operational planning cycle.

On stress-testing, the ECB believes that the proposal contradicts the Commission's objective of strengthening the stability of the internal market: firstly, by unduly complicating the process; secondly, by potentially leading to disclosure of confidential information; and, thirdly, by not adequately ensuring the quality of stress tests. The ECB calls for deletion of provisions in the proposal relating to stress testing.

On independent reviews of competent authorities, the ECB sees no reason to abandon the existing peer review mechanisms, which it regards as valuable and successful, but supports certain elements of the proposal that transform peer reviews into independent reviews.

On delegation and outsourcing of activities and risk transfer to third countries, the ECB regards the proposal as adding unnecessary administrative burden to a process that already includes the relevant competent authority and the ECB.

On equivalence, the ECB welcomes the ECB's proposed role, but requests clarification that the competent authority would still be responsible for coordinating supervisory activities and on-site inspections. The ECB also raises the issue of the EBA's proposed administrative arrangements interfering with negotiations of Memoranda of Understanding with third countries.

¹ https://www.ecb.europa.eu/ecb/legal/opinions/html/act_14818_amend.en.html

On fines and requests for information, the ECB agrees that the EBA should have the right to collect necessary information, but believes this should be without prejudice to competent authorities' right to exercise their own powers with respect to requests for information.

Finally, the ECB suggests integrating data subject to supervisory reporting with quantitative Pillar 3 disclosure requirements, with a central data repository at the EBA. This would require a legal mandate to make data public without the explicit consent of financial institutions. The ECB suggests the legal and practical feasibility of this should be explored.

The ECB's Opinion is broadly in line with the Government's position on the proposal. The only notable exception is the section on data reporting. The Government recognises the theoretical efficiencies associated with centralisation of data, but we question whether these efficiencies would be realised in practice.

I note also that the ESFS package is provisionally on the agenda for the June ECOFIN meeting. If the item remains on the agenda, I will update you on the outcome after the meeting, as requested.

I am copying this letter to the Chair of the House of Lords European Scrutiny Committee; Lynn Gardner, Clerk to the Commons Committee; Chris Johnson, Clerk to the Lords Committee; Eliot Wilson, Clerk to the Lords Financial Affairs Subcommittee; Les Saunders, Department for Exiting the EU; Frances Milsom and Ross Turner, HM Treasury.

With very best regards

John

JOHN GLEN MP

ECONOMIC SECRETARY TO THE TREASURY

