AMIC Review

MARKET | REGULATION | INVESTORS

AMIC
The buy side voice of ICMA

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Welcome

Martin Scheck,
Chief Executive, International Capital Market Association (ICMA)

Following on from the success of the first AMIC review published in 2016 I am very pleased to welcome readers to the second edition of this publication. The purpose of this Review is to highlight the role of the buy-side in ICMA, to remind readers of the objectives of AMIC and to highlight its achievements over the past year.

The buy-side continues to play an important part in ICMA's work. In order to promote resilient and well-functioning international debt capital markets it is important to bring all segments of the industry together and encourage dialogue. ICMA is ideally placed to do this as it is one of the few trade associations with a European focus that has both the buy-side and sell-side represented within its membership.

ICMA's board also reinforces this view, with the appointment this year of Andreas Utermann, CEO of Allianz Global Investors, bringing the buy-side representation up to four members. The ICMA board plays an active role in steering ICMA's work and we are grateful to board members for their commitment and for promoting a high degree of participation of their firms in the working groups, which are the lifeblood of ICMA. We are pleased to once again feature in this review articles from Andreas Utermann, Allianz Global Investors and from Joanna Cound, BlackRock who are both board members.

AMIC continues to strengthen its brand as a voice for the buy-side of ICMA. In this past year, AMIC has contributed to the debate on leverage risk in investment funds via its joint report on the topic with EFAMA, contributed to the topic of research unbundling in MiFID II, represented its members' views on a range of topics by responding to consultations, and held two successful conferences, the spring AMIC conference and the Covered Bond Investor Conference, both of which took place in Frankfurt.

It has been encouraging to see that buy-side ICMA members – whether AMIC participants or not – are playing an increasingly active role in ICMA's cross industry committees and working groups that represent the industry as a whole. Examples include the Secondary Market Practices Committee (SMPC) and the European Repo and Collateral Council (ERCC) which have seen growing buy-side participation with significant buy-side contributions in working groups dealing with MiFID II/R. A buy-side co-chair has been appointed to the Secondary Market Practices Committee since last year to ensure that the buy-side interests are fully taken into account in its discussions.

One of ICMA's roles is to bring market participants together and the buy-side is regularly consulted in other areas of ICMA's work. Our issuer forums, representing public sector borrowers, corporate issuers and financial institutions have been keen to engage with buy-side speakers in meetings or discuss common topics. The Bail-in Working Group and the Financial Institution Issuer Forum have already held discussions on areas of mutual interest. There is clearly scope for more cooperation between the AMIC and these forums in the future. ■

"AMIC continues to strengthen its brand as a voice for the buy-side of ICMA."

AMIC

The independent voice of the buy-side within ICMA

Robert Parker,
Chair of the ICMA Asset Management and Investor Council (AMIC)

To reflect the growing importance of the buy-side in the marketplace in general and the value public authorities give to the buy-side voice, ICMA decided in 2008 to set up an Asset Management and Investors Council (AMIC) which I have chaired since then. This publication is one of the ways we promote the buy-side, now in its second edition after its launch last year.

AMIC was established to represent the views of the buy-side members of ICMA and to add value by discussing investment issues of common interest, with the aim of reaching a consensus and recommending any action that ICMA should take. It has grown to a fully structured Council within ICMA encompassing more than 200 contacts and now organises biannual conferences, quarterly Executive Committee meetings and several working groups. Only buy-side members are invited to join the AMIC's sub-committees and working groups.

AMIC's main tasks include:

- discussing macro level industry and regulatory issues;
- identifying and suggesting solutions to practical issues for members at a technical level;
- coordinating market-led initiatives in response to the challenges it has identified;
- preparing responses to the authorities, representing the views of AMIC's cross border membership such as international asset management, wealth management and investors;
- engaging with regulatory authorities, as AMIC or as part of a cross-industry group, at national, European and international level in a world where the regulatory authorities are increasingly moving from a national to an international remit;
- working to ensure that authorities fully understand the consequences of any regulatory proposals for the asset management and wealth management industry; and
- promoting buy-side members within other ICMA committees and working groups, to ensure that buy-side concerns are better reflected in ICMA's output.

The Asset Management and Investors Council

All AMIC members are equally represented on the AMIC Council which meets regularly to discuss broad industry issues and to guide the AMIC Executive Committee on the choice of projects and working groups. The AMIC Council holds two plenary sessions annually, both to advise the Executive Committee of AMIC on priorities and to discuss current issues at biannual conferences – organised in the spring in a continental European city and in the autumn in London.

The AMIC Executive Committee

The Executive Committee is effectively the executive arm of the Council and comprises a subset of Council members. The Executive Committee is composed of individuals representing institutions which are full ICMA members. The Executive Committee takes account of the views of the Council and is responsible for the "public output" of the AMIC, such as opinions on regulatory and market practice developments, responses to consultation papers, etc. The Executive Committee also calls upon experts on specific topics. The Executive Committee meets four times a year allowing members to discuss the most topical buy-side issues of the day.

At the beginning of 2017 AMIC appointed two Vice-Chairs to sit alongside the Chairman. The Vice-Chairs are Stéphane Janin, Head of Global Regulatory Developments at AXA Investment Managers and Axel van Nederveen, the Treasurer of the European Bank for Reconstruction and Development (EBRD). The Vice-Chairs provide additional leadership to AMIC and contribute to the setting of the AMIC agenda and discussion topics.

The AMIC working groups

The working groups are the core of the AMIC. The AMIC has set up a number of temporary and permanent working groups and Councils. Some are asset class-focused (covered bonds, securitisation) and some look at industry issues (systemic risk such as fund liquidity and leverage in funds, central bank activities, interest rates and quantitative easing, corporate governance). External experts are also invited to join the working groups when relevant.

The AMIC Secretariat sends a weekly update to contacts, outlining its current activities and a specific regulatory update. Sign up by contacting **amic@icmagroup.org**

The AMIC Secretariat is in constant contact with AMIC members. To ensure that the AMIC brand is maintained in the wider investor community and to step up awareness of ICMA's buy-side activities, the AMIC Secretariat also sends out a weekly regulatory update, with information about key AMIC developments, to a broad list of recipients.

The Secretariat of AMIC is small and therefore quite capable to flexibly respond to the needs of its membership. The overall working group structure allows for permanent as well as temporary working groups. I would encourage any AMIC Council member to get engaged with the working groups, or at the very least get the weekly update to keep abreast of our current activities and priorities. ■

Contact: amic@icmagroup.org

Key AMIC achievements and current initiatives

- On Market Finance, the AMIC is actively engaged with regulators in the current debate over systemic risk in asset management. The AMIC has recently published, alongside the European Fund and Asset Management Association (EFAMA), a report on the use of leverage in investment funds, with a view to contribute to the on-going international debate on leverage.

- AMIC continued its contribution to the parallel debate on liquidity risk management by responding to IOSCO's consultations on best practices in liquidity risk management. AMIC welcomed the report, suggested some amendments to the recommendations and noted that it helpfully references AMIC's 2016 joint report with EFAMA on liquidity risk management.

- Regarding MiFID II, AMIC has explored the implications that research unbundling will have on both asset managers and end investors. In order to keep members up-to-date, AMIC did a summary of surveys and once it noticed that fixed income was being overlooked beside equities it ran its own FICC focused survey - the results of which have been released (8 November 2017) at this AMIC conference in London.

- AMIC has long taken an interest in the development of ETFs and responded to the Central Bank of Ireland's (CBI) Discussion Paper on ETFs addressing potential systemic risks in ETFs and their impact on corporate bond liquidity.

- Through its Securitisation Working Group, AMIC has provided investor input into the legislative process behind the simple, transparent and standardised (STS) securitisation regulation. Through coordination with other industry representative bodies a successful compromise on the regulation has been achieved. Among others positive outcomes, AMIC welcomes that third party attestation is allowed in the final text.

- AMIC has been key in the establishment of European Corporate Debt Private Placement Joint Committee (ECPP JC), which is known for developing Pan-European Corporate Private Placement Market Guide. More recently the ECPP the JC published a joint report with the Association for Financial Markets in Europe (AFME) called European Infrastructure Finance: a Stock-take a review of the state of infrastructure financing, investment and related initiatives in Europe, and an assessment of how to further advance and encourage private sector finance for infrastructure projects.

- AMIC's Covered Bond Investor Council (CBIC) held its annual investor conference in Frankfurt in partnership with the Covered Bond Report. The conference covered topics such as the ECB's third covered bond purchase programme (CBPP3) and its effect on investors, an analysis of an eventual exit strategy for the central bank, the prospect of an EU covered bond directive in 2018, evolving maturity structures, the latest developments on the harmonised transparency template (HTT) and the emerging market of green covered bonds.

- AMIC's spring conference was also held in Frankfurt, and covered the ECB's Asset Purchase Programme (APP) and its effect on investors, systemic risk in asset management, focusing on liquidity and leverage risk management in funds and the development of the green bonds market from the perspectives of both investors and issuers.

Industry innovation is key to unlocking shared value for clients

Andreas Utermann,
CEO, Allianz Global Investors and ICMA board member

The asset management industry has grown and matured considerably in the past 30 years. In so doing, the investment universe and range of strategies has expanded to meet clients' evolving needs, making the industry more diverse, more intermediated and more complex than it was.

Recent regulatory interest in the industry has focused in particular on the subject of value for money. We should embrace this discussion and consider new ways to address clients' varied expectations and needs.

A challenge for active managers

Proponents of active management have value propositions and reputations that are, among other things, built on the ability to achieve investment returns for clients that are at or above a particular benchmark or agreed target.

Seeking to beat the market is an expensive business, in terms of hiring and retaining talented individuals; undertaking research that allows us to achieve investment insights that others miss; discussing our ideas within and across teams to sharpen our convictions on where the best investment opportunities lie; and establishing and maintaining robust investment processes and investment reviews that help ensure that an investment strategy lives up to its billing.

Yet, for all the sophistication, care and skill active managers employ, achieving outperformance year in and year out cannot be guaranteed. Indeed, in a few core equity benchmarks there is data pointing to a majority of active managers falling short of their target in recent years. Some of the reasons for underperformance are structural and go beyond the ability of Asset Managers to address (eg bundled distribution and portfolio management fees in mutual funds in most markets, which lower the net return to end investors and give the (false) impression of Asset Managers charging very high fees for active management). The more forward thinking Asset Managers have been taking action to sharpen their ability to achieve meaningful alpha for their clients and tailoring strategies more closely to individual clients' needs.

There is also no getting away from the fact that the 'price of beta' or 'market access fee' has been compressed significantly with the broad availability of index ETFs and smart beta products – and active managers have not responded to that particular challenge. Consequently, retail and institutional clients have shifted, and are shifting, to passive products in large numbers, in many instances preferring the guarantee of lower management costs to the possibility of higher performance.

A way forward on pricing

Allianz Global Investors is confident that clients will continue to seek out managers who can deliver alpha as a means of achieving their desired investment goals. We assume that clients will continue to be prepared to pay a fair price for performance.

Indeed, we believe that a large cross section of investors who have moved to passive – or may be tempted to move that way – can again be attracted to active investment offerings if the price is right. All it will take is some innovation.

AllianzGI has modelled a new pricing structure, which will be introduced in the US and the UK in the coming months. In essence, we will charge a very low base management fee (implicit in the US, explicit in the UK) plus a performance fee, charged only for outperforming the relevant benchmark.

While performance fees have long been offered in selective markets and in particular in the institutional space and for alternative strategies, this approach is relatively little used among long only strategies in the retail space. And it is here that we are now embarking on a broader roll out.

This approach won't work in every market: note that we are starting in markets where retail distribution fees are unbundled from portfolio management fees. Nor will the approach work for every strategy: some do not have a suitable benchmark for instance.

And, of course, the pricing won't appeal to every client: those who are confident of our ability to outperform consistently may well prefer to stick with the traditional fixed fee.

However, we suspect that this new pricing option will prove attractive to many investors who have been switching to passive in recent years. If so, we anticipate many other asset managers will follow in this path on pricing.

The rub?

For some active managers (or their owners), the greater level of revenue volatility implied by such pricing may prove unacceptably high. However, for those of us who are fully and unambiguously committed to active management, we need to have the courage of our convictions.

To manage the revenue volatility and to make the most of performance-related pricing, asset managers would be well advised to do three things:

1. Budget conservatively. We all know that past performance can be a poor indicator of future performance; so a healthy discount should be applied to whatever the modelling indicates will be the likely performance fees.
2. Pay extra attention to performance. A number of factors have conspired to turn some traditional long-only active managers into inadvertent or, less charitably, 'closet' index trackers. Active managers will need to develop more concentrated portfolios with conviction picks and include off-benchmark securities to demonstrate the skill that leads to outperformance.
3. Diversify. Even if revenue volatility at a product level cannot be avoided, asset managers can mitigate its effects at a corporate level by pursuing a broad spread of exposures by geography, asset class, investment style and client type.

Without a robust and rapid response by Asset Managers along the lines highlighted above, a mind-set of shared economics with the clients and wholesale retooling of the investment process, industry consolidation will continue apace and the number of global, pure 'active' managers will fall to less than a handful. This would lead to less choice for investors and ultimately poorer aggregate investment outcomes for individuals and societies at large. ■

Coming of Age – ETFs in the Spotlight

Joanna Cound,

Head of Global Public Policy Group, EMEA, at BlackRock and ICMA board member

The continuing growth of assets in Exchange Traded Funds (ETFs) has led to greater investor focus on their structure and mechanics. It has also led to increased interest from regulators and policy makers at the global, European and national levels, particularly given the spread of confusing headlines regarding the role and impact of ETFs and other Exchange Traded Products (ETPs) in markets.

BlackRock welcomes this focus - particularly so where regulators actively seek informed views on the product and how the market operates. BlackRock believes that well-structured ETFs can be highly beneficial both to investors and securities markets, although certain types of exchange traded products raise issues that deserve further consideration by regulators and investors alike.

Recent discussions with policy makers on ETFs generally centre on three important concepts, which underpin an understanding of the product and provide a framework for other lines of enquiry. First, it is important to highlight how the ETF "arbitrage mechanism" is a fundamentally important concept to maintain the market price of ETF shares near the fair value per share of the ETF. Second, the relationship between premiums, discounts and price discovery often requires explanation. A third topic is ETP naming conventions. In our view, policy makers could consider a systematic classification and labelling scheme that better distinguishes the different types of ETPs, and their highly varied structural risks, for investors. In the following article we discuss these three concepts in more detail.

"BlackRock believe that well-structured ETFs can be highly beneficial both to investors and securities markets."

I. The Arbitrage Mechanism

The so-called "arbitrage mechanism" – the incentive for large financial institutions to buy ETF shares when those shares trade at a discount to the ETF's intrinsic value and to sell ETF shares when those shares trade at a premium to an ETF's intrinsic value – is critical to understanding ETFs.

Like closed-end funds, ETFs can be bought or sold intraday on an exchange at a market-determined price.

Exchange transactions directly between buyers and sellers provide each with liquidity without requiring the ETF to buy or sell holdings. Unlike closed-end funds, however, ETFs incorporate a mechanism for keeping the market price within close range of the ETF's Net Asset Value (NAV) by adjusting the supply of available shares based on investor demand.

Most ETF investors can trade shares only on the exchange. Nonetheless, a small group of investors, known as Authorised Participants (APs) can trade directly with an ETF. APs are sophisticated institutional trading firms that enter into a contract with the ETF. The AP specifies the rules for creating and redeeming ETF shares. APs are not agents of the ETF – they are not required to create or redeem ETF shares under any circumstances, and only do so when it is in their interest. Some APs act only on their own behalf, while others may act as agents for a variety of clients.

II. Premiums, Discounts and Price Discovery

The fact that an ETF's shares may trade at a price higher or lower than the ETF's most recently calculated NAV is sometimes viewed as a failure of ETFs. Premiums and discounts that result from comparing an ETF's most recently calculated NAV to its current exchange price may occur for a variety of reasons, some of which result from real market supply-and-demand forces at work and others which result from timing gaps or other small differences between NAV calculation and exchange pricing. We therefore do not consider that the existence of a small premium or discount is necessarily a meaningful indicator of deviation from fair value. For example, during periods of bond market volatility, fixed income ETFs may exhibit larger-than-usual discounts to their most recently calculated NAV. At the height of the Financial Crisis (October-November 2008), several large fixed income ETFs experienced discounts of as much as 8% to 11%.

The volume of exchange trading in fixed income ETFs tends to spike when markets reprice fixed income assets.

For example, during the Financial Crisis, as liquidity in corporate bonds traded over-the-counter deteriorated in June 2008, the iShares iBoxx $ Investment Grade Corporate Bond ETF (LQD) continuously traded on exchanges in an orderly manner and more than quadrupled volume. Similarly, the so-called "Taper Tantrum" in the summer of 2013 followed an unexpected announcement by the Federal Reserve that it intended to cut back its ongoing program of repurchasing bonds, sparking widespread fear of rising interest rates. Bond prices fell steeply during 18-19 June, followed by a rebound the following week. During the selloff, volume in the iShares iBoxx $ High Yield Corporate Bond ETF (HYG), the largest U.S. high yield bond ETF, rose to 25% of the underlying high yield bond market providing incremental liquidity at the time it was most necessary.

"ETFs provide insight into the prices at which an ETF's underlying assets can really match willing buyers with willing sellers, and the direction of those prices."

The discount widening observed during these periods results from two separate phenomena:

- First, ETFs are priced in real time, NAVs are not. ETF share prices and NAV incorporate new information differently. ETF shares price on an exchange, where they are set intraday by actual transactions between willing buyers and sellers. They are, therefore, able to move quickly to incorporate new information and reflect prevailing market conditions. NAV, in contrast, is calculated once daily based on known previous transactions or model-based estimates of fair value, which may be difficult to capture accurately when prices are falling and bonds are trading infrequently. Fixed income ETF NAVs are backward-looking and necessarily adjust to new price information with a lag, whereas fixed income ETF share prices are forward-looking and incorporate new information quickly and dynamically. In comparisons between ETF closing share prices and NAV on which premium/discount data is based, the ETF closing share price reflects all information then currently known in the aggregate by market participants, while the NAV reflects only the information then currently known (and able to be reflected in valuations) by the persons involved in determining the NAV. Fixed income ETF share prices therefore tend to "lead" other indications of bond values, providing insight into the true level of the market for the underlying securities. By allowing market participants to set a price for a basket of securities, many of which may not be trading, ETFs permit price discovery.
- Second, liquidity has a cost. When sellers of shares exceed buyers, the price of the shares on the exchange declines. This is the normal means for balancing supply-and-demand for equities. In stressed bond markets, market participants seeking to reduce bond exposure may seek to sell ETF shares because it is easier, quicker and more certain than seeking to sell large amounts of individual bonds, many of which may have no bids. When selling demand is concentrated in an ETF's shares, those shares will decline in price to a level that attracts willing buyers. This selling activity may drive the ETF share price to a level below some indications of "fair value". It nevertheless represents the market's price for current liquidity, as ETF arbitrage requires APs and other market participants to sell bonds or equivalent exposures at currently realizable prices in order to hedge risk to any ETF shares purchased. We therefore see reasonable discounts in stressed markets as an indication that the arbitrage mechanism is functioning, not of "deterioration".

In summary, ETFs provide insight into the prices at which an ETF's underlying assets can really match willing buyers with willing sellers, and the direction of those prices. This price discovery attribute is an important benefit of ETFs. ETF premiums and discounts typically occur in connection with valid price discovery, and a well-functioning arbitrage mechanism will cause the premium or discount to revert to normal levels when excess demand for shares (premiums) or liquidity (discounts) either is satisfied or dissipates.

III. The Need for Improvements in ETP Classification

While all ETPs share certain characteristics, including exchange-tradability, "ETF" has become a blanket term describing many products that have a wide range of different structures and risks, which has led to a great deal of confusion. Not only are ETFs different from other types of ETPs, the various types of ETPs have different structural risks that are masked by use of a common descriptor. Agreement on a common taxonomy would improve investors' ability to understand and analyse the risks of individual ETPs. The ETP industry today could do even more to explain the structural risk differences among ETPs consistently, in our view.

Naming conventions are quite important, especially in a regulatory context. In 2011, BlackRock introduced an ETP classification system based on risk-based distinctions and has four sub-types of ETPs. Whilst this convention resonates with investors and has been voluntarily adopted across the industry, regulation lags in this regard with the SEC, ESMA and IOSCO only partially recognizing the variance across ETPs.

ETP Naming Convention

Exchange Traded Product (ETP)

- Catch-all term for any portfolio exposure product that trades on an exchange.
- ETFs, ETCs, ETNs, and ETIs, are all subsets of ETP.

Exchange Traded Fund (ETF)

- ETFs are publicly-offered investment funds that trade on an exchange.
- ETFs can track a specific index or employ active strategies (via a transparent basket) that meet diversification and liquidity thresholds set by regulators and exchanges.
- ETFs' underlying securities can include stocks, bonds or other investment instruments (e.g., bank loans).
- As noted below, this category should exclude funds with embedded leverage or inverse features.
- According to the 2014 ESMA Guidelines, only ETPs registered as UCITS can use the ETF label.

Exchange Traded Note (ETN)

- Debt instruments that provide an index-based return. ETNs may or may not be collateralized, but depend on the issuer's solvency and willingness to buy and sell securities to deliver fully to expectations.
- As noted below, this category should exclude notes with embedded leverage, inverse features or options.

Exchange Traded Commodity (ETC)

- A variety of fully-collateralized legal structures that are not ETNs but seek to deliver the unleveraged performance of a commodity, or basket of commodities.
- Some ETCs may hold physical commodities, while others invest in commodity futures.
- ETCs that invest in commodity futures may raise special issues because futures do not precisely track spot commodity prices.

Exchange Traded Instrument (ETI)

- An ETI is any ETP that has embedded structural features designed to deliver performance that will not track the full unlevered positive return of the underlying index or exposure (that is, products that seek to provide a leveraged or inverse return).

Questions from regulators and policy makers raised about ETFs in general, and about APs specifically, highlight the need for more informational materials on these topics Trade Associations have an important role to play in this regard.

There are also several areas where policy makers, regulators, and the industry can act to strengthen the ecosystem around ETFs, decrease operational risk, increase efficiency and reduce the cost of trading. These include implementing a clear classification system for ETFs, to complement the advances in European ETF market structure we are expecting the entry into force of MiFID II in January 2018 will bring. ■

The future of the European supervisory authorities

Frédéric Bompaire
Public Affairs, Amundi

An open consultation on the review of European Supervisory Authorities (ESAs) regulations closed mid-May 2017 and as early as 20 September 2017 the European Commission (EC) issued a proposal for an omnibus regulation (apparently the EC asked its relevant staff not take holidays during the summer).

The proposal aims to amend nine different EU texts, taking into consideration the numerous (well above 200) responses by stakeholders to the consultation. The text articulates changes concerning the powers, the governance, and the funding of ESAs. There are many positive sides in the EC proposal and the current discussion period could bring further improvement. Let us mention a few items.

Powers

The construction of the EU and of a capital markets union (CMU) implies a strong move to develop and implement a single rulebook. Harmonisation and convergence, down to operational details in many cases, are paramount. So far, EU institutions have not been completely successful in accomplishing this task. The preference to issue regulations (directly binding) instead of directives (that need to be implemented in Member States) is one way to address the issue of regulatory discrepancies that the national transposition enables. Direct supervision, at the level of the ESAs, is a tempting alternative to ever increasing coordination efforts to ensure a level playing field. However, it is not a solution.

"There are many positive sides in the EC proposal and the current discussion period could bring further improvement."

If we take the example of asset management, the point has been made on several occasions, including by EC officials, that the closer to the retail investor you are, the more relevant national supervision is. Proximity is effectively the best way to avoid developing supervisory expertise that already exists at the level of national competent authorities (NCAs).

Furthermore, the legal framework differs from one country to another, as does language and cultural backgorund. Also, tax is a national competence and marketing rules and channels are not standardised. If the direct supervision of central counterparties (CCPs), critical (and third country) benchmarks, as well as data reporting service providers by ESMA is not problematic, the introduction of direct supervision at the European level to funds is very concerning.

The EC proposal suggests that European Social Entrepreneurship Funds (EuSEF), European Venture Capital funds (EuVECA) and European Long-Term Investment Funds (ELTIF) should be authorised by ESMA. The foreseen three types of funds are not widely used currently, but they typically use national legal formats that are best adapted to their objective and ESMA may simply not be accustomed to the structures. The funds are not limited to professional clients, which means that retail investor protection rules apply at the national level and, in case of breaches, national courts are used.

In a nutshell, direct supervision should not be used as a substitute for convergence in both regulation and supervision. This is the role of ESAs and they should concentrate on it. Under the current ESA regulations (from 2010), the ESAs have a number of effective tools to promote convergence and they should make better use of them. Typically, guidelines can be more efficiently used to promote convergence. The "comply or explain" rule does not mean that in case of non-compliance a Member State can carry on without converging. On the contrary ESAs already have the power and should build a convergence plan and effectively monitor it until its achievement or until someone complains about a breach of the common rule. To be more flexible this procedure could include the possibility for the ESAs to more easily amend their guidelines.

Governance

One positive aspect of the proposed regulation is the introduction of an Executive Board (EB) whose members will be selected in a transparent way and appointed by EU institutions. Of course, the process might not lead to the optimal composition in terms of diversity or professional experience. The transfer of some powers from the current Board of Supervisors to the EB will greatly improve the resolution of breaches of EU law for example and therefore facilitate convergence. However, there is a need for some counter balance to the EB and the Board of Supervisors, which can be found in the Stakeholder Groups (SG).

Regulators could go further in enhancing the role of the SG and other committees where professional experts are invited to participate. A first step is already in the proposal, which enables the SG to swiftly report diverging opinions if the consensus is not met. The next move should be to introduce an obligation for the ESAs to carefully respond to all issues and suggestions made by the SG and to systematically reconsider the initial text as a result. Another step in the right direction is the possibility for the SG to be able to challenge (addressed to the EC) the capacity of an ESA to address an issue that arguably exceeds its competence. But such a challenge should only be invoked on the basis of a simple majority decision.

Funding

The EC proposal suggests that the ESAs should in the future be part-funded by industry. It is difficult to be positive about this suggestion. There are two major risks. First, the legal basis for direct contributions paid by market participants to an authority which has only indirect supervision powers over them is questionable. Even if NCAs collect those contributions, the amount will be determined by ESMA according to the need to balance its budget. The second point is more important. It relates to the end of the strict control on ESAs expenses that a fixed percentage of their budget coming from the EU budget granted.

The current 40% proportion contributed by the EU general budget would disappear and that means that the ESAs expenses could increase far more rapidly and without limit: ex post control is not sufficient. Such a development feeds a very negative feeling among so many EU citizens that the EU bureaucracy is continuously expanding at a heavy cost for taxpayers and without proper control. Nobody will believe that, as suggested in the impact assessment, there is a fair trade-off between the expansion of the budget of ESAs and a corresponding reduction of the budget of NCAs.

On the edges of the proposal's suggestions about governance and powers, another point seems problematic. ESAs would receive new powers in terms of communication of information, on-site inspection and sanctions. This section, that is copied several times in the different legislation being amended, is not as benign as it sounds. It raises a central question with regard to the respect of the right to defend against accusation and the rationale for introducing such powers to ESAs on matters that often directly depend on supervision by NCAs.

Far from being purely technical, the review of the ESAs relates to public confidence in European Institutions – this is a highly political exercise. ■

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