



EUROPEAN SYSTEM OF FINANCIAL SUPERVISION (ESFS)

The European System of Financial Supervision (ESFS) is a multi-layered system of micro- and macro-prudential authorities that includes the [European Systemic Risk Board](#), the three European supervisory authorities and the national supervisors. The ESFS aims to ensure consistent and coherent financial supervision in the EU. This supervisory system is undergoing changes further to the introduction of the Banking Union and the anticipated withdrawal of the United Kingdom from the EU.

LEGAL BASIS

Articles 114 and 127(6) of the Treaty on the Functioning of the European Union (TFEU).

BACKGROUND AND OBJECTIVES

Following the recommendations of [the report](#) by the de Larosière expert group on strengthening the European supervisory arrangements, the ESFS was introduced in 2010 and became operational on 1 January 2011. The ESFS consists of the [European Systemic Risk Board](#) (ESRB), the three European supervisory authorities (ESAs) – namely the [European Banking Authority](#) (EBA), the [European Securities and Markets Authority](#) (ESMA) and the [European Insurance and Occupational Pensions Authority](#) (EIOPA) – and the national supervisors.

The main objective of the ESFS is to ensure that the rules applicable to the financial sector are adequately implemented across Member States in order to preserve financial stability, promote confidence and provide protection for consumers. The objectives of the ESFS also include developing a common supervisory culture and facilitating a single European financial market.

The ESFS is a system of micro- and macro-prudential supervision. The main objective of micro-prudential supervision is to oversee and limit the distress of individual financial institutions, thus protecting consumers. Macro-prudential supervision, on the other hand, is concerned with the exposure of the financial system as a whole to common risks, and aims to limit its distress in order to protect the overall economy from significant losses in real output. In the context of the ESFS, the ESRB is responsible for the macro-prudential supervision of the EU financial system, while the micro-prudential oversight is performed by the EBA, the ESMA and the EIOPA, which work together in a joint committee.

The establishment of the Banking Union in 2012 changed the shape of the EU supervisory framework as it introduced new elements – such as a single rulebook



for supervision, the [Single Supervisory Mechanism](#) (SSM), which became operational in 2014, the [Single Resolution Mechanism](#) (SRM), which became operational in 2016, and the European Deposit Insurance Scheme (EDIS). Negotiations on the EDIS are still ongoing.

FRAMEWORK

A. Micro-prudential supervision

In the EU, micro-prudential supervision is characterised by a multi-layered system of authorities separated according to sectoral area (banking, insurance and securities markets) and the level of supervision and regulation (EU and national).

1. European supervisory authorities (ESAs)

At the European level, the ESAs are responsible for micro-prudential supervision. The EBA, the EIOPA and the ESMA are EU agencies with their own legal personalities and which are represented by their respective chairpersons. They are independent and act only in the interests of the Union as a whole. In September 2017, the Commission issued the 'ESA Review Package' consisting of three legislative proposals, with the aim of reinforcing the powers, governance and funding of the ESAs.

The regulations establishing the ESAs define their main objective as to contribute to the stability and effectiveness of the financial system. The ESAs play a role in: facilitating the smooth functioning of the internal market – including in particular a sound, effective and consistent level of regulation and supervision; ensuring the integrity, transparency, efficiency and orderly functioning of financial markets; strengthening international supervisory coordination; preventing regulatory arbitrage and promoting equal conditions of competition; ensuring that any relevant risk-taking is appropriately regulated and supervised; and enhancing customer protection.

The ESAs contribute to the development of a single rulebook by drafting Regulatory Technical Standards and Implementing Technical Standards, which are adopted by the Commission (as delegated or implementing acts). They issue guidelines and recommendations and have certain powers in cases of breaches of EU law by national supervisory authorities, emergency situations and disagreements between competent national authorities.

The three ESAs are organised in the same way. Their governance structure includes the Board of Supervisors (the main decision-making body, which consists of the Chairperson, the head of the competent supervisory authority in each Member State, and one representative from each of the Commission, the European Central Bank (ECB), the ESRB and the other two ESAs), the Management Board, a Chairperson and an Executive Director.

a. European Banking Authority (EBA)

Legal basis: Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) [as amended by subsequent legislation](#).

The [EBA](#)'s seat is currently in London. However, given the anticipated withdrawal of the United Kingdom from the EU, the EBA is gradually moving its operations to offices



in Paris and will be fully operational in its new premises from June 2019. The purview of the EBA encompasses credit institutions, financial conglomerates, investment firms, payment institutions and e-money institutions. The EBA is also tasked with initiating and coordinating, in cooperation with the ESRB, EU-wide stress tests of the banking sector. The last stress test was conducted in [2018](#), and the next will be undertaken in 2020.

b. European Insurance and Occupational Pensions Authority (EIOPA)

Legal basis: Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority) [as amended by subsequent legislation](#).

The [EIOPA](#)'s seat is in Frankfurt am Main. It is primarily concerned with insurance and reinsurance undertakings, insurance intermediaries, financial conglomerates and institutions for occupational retirement provision. It contributes to the single rulebook on insurance and occupational pensions mainly through the [Solvency II](#) and [IORP](#) regimes, respectively. The EIOPA initiates and coordinates stress tests to assess the resilience of the insurance and pensions sectors. The last insurance stress test was completed in [2018](#), while the most recent occupational pensions stress test was launched in April [2019](#). The stress test report is due to be published in December 2019.

c. European Securities and Markets Authority (ESMA)

Legal basis: Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) [as amended by subsequent legislation](#).

The [ESMA](#) is located in Paris. Its purview covers securities markets and participants (exchanges, traders, funds, etc.). In the EU, the ESMA has sole responsibility for the registration, supervision and sanctioning of credit rating agencies and trade repositories. It is also in charge of recognising third-country (i.e. non-EU-country) central counterparties and trade repositories and of the certification and endorsement of third-country credit rating agencies.

The ESMA conducted its second central counterparty stress test in [2017](#) and launched a third in April [2019](#).

2. Joint bodies

a. Joint Committee of the European Supervisory Authorities

The Joint Committee is responsible for overall and cross-sectoral coordination, with the aim of ensuring supervisory consistency. As outlined in the ESA Regulations, this includes the following areas: financial conglomerates; accounting and auditing; micro-prudential analyses of cross-sectoral developments, risks and vulnerabilities of financial stability; retail investment products; measures to combat money laundering; information exchange between the ESRB and ESAs; and the development of relations between these institutions. The Joint Committee is responsible for the settlement of disputes between ESFS authorities.

The Joint Committee is composed of the Chairpersons of the ESAs (and of possible subcommittees) and chaired by one ESA Chairperson for a rotating 12-month term. The Chairperson of the Joint Committee is the Vice-Chair of the ESRB. The Joint Committee



must meet at least once every two months. The secretariat is made up of staff from the ESAs.

b. Board of Appeal

The Board of Appeal is independent from the three ESAs and is responsible for appeals from parties affected by the decisions of the ESAs.

It is composed of six members and six alternates appointed by the ESAs for a five-year term, based on a shortlist proposed by the Commission.

The decisions of the Board of Appeal can be contested before the Court of Justice of the European Union.

3. Competent national supervisory authorities

Each Member State designates its own competent authorities, which form part of the ESFS and are represented in the ESAs.

B. Macro-prudential oversight

European Systemic Risk Board (ESRB)

Legal basis: [Regulation \(EU\) No 1092/2010](#) on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board and [Council Regulation \(EU\) No 1096/2010](#) conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board.

Macro-prudential oversight is carried out at EU level by the ESRB. Its objective is to prevent and mitigate systemic financial stability risks in the light of macro-economic developments. The founding regulations confer various tasks upon, and provide instruments to, the ESRB, including: the collection and analysis of relevant information; identifying and prioritising systemic risks; issuing warnings and recommendations and monitoring their follow-up; providing an assessment to the Council when the ESRB determines that an emergency situation may arise; cooperating with other parties to the ESFS; coordinating its actions with international financial organisations such as the International Monetary Fund (IMF) and the Financial Stability Board (FSB); and carrying out tasks specified in other EU legislation.

The ESRB is composed of a General Board, a Steering Committee, two advisory bodies (Advisory Scientific Committee and Advisory Technical Committee) and a secretariat.

The ECB provides analytical, statistical, administrative and logistical support to the ESRB. The President of the ECB is also the Chair of the ESRB. In 2014, the Commission published a [report](#) on the mission and organisation of the ESRB.

C. Cooperation at various levels

The various entities within the ESFS also coordinate at international level with various institutions.

DEVELOPMENT OF THE SUPERVISORY FRAMEWORK

The financial crisis showed that simple coordination of financial supervision via the ESFS was not sufficient to prevent fragmentation of the European financial market. In order to overcome this obstacle, the EU [Banking Union](#) was established. As one of



the Banking Union's main pillars, the [SSM](#) is a particularly important element of the supervisory framework. Its objective is to ensure consistent and coherent supervision of credit institutions in order to prevent regulatory arbitrage and fragmentation of the financial services market in the EU. The SSM consists of all euro-area Member States, plus any non-euro-area Member States that decide to join. The SSM is composed of the ECB and the competent national authorities, which cooperate and exchange information. The ECB is responsible for the effective and consistent functioning of the mechanism. As of November 2014, the [SSM Regulation](#) confers specific tasks on the ECB. These include authorising credit institutions, ensuring compliance with prudential and other regulatory requirements, and carrying out supervisory reviews. The ECB is responsible for the direct supervision of 'significant' banks while national authorities supervise other 'less significant' institutions. Besides these micro-prudential tasks, the ECB also has macro-prudential tasks and tools at its disposal, for example in relation to capital buffers. For this purpose, the governance structure of the ECB has been adapted through the establishment of a Supervisory Board. In order to ensure consistent supervision, the ECB cooperates closely with the other authorities that make up the ESFS, in particular with the EBA.

ROLE OF THE EUROPEAN PARLIAMENT

Parliament, as co-legislator, played an important part in setting up the founding legislation for the ESFS, and also plays a major role in negotiating legislation under the various pillars of the Banking Union. It has a role as regards delegated acts (including Regulatory Technical Standards) and implementing acts (including Implementing Technical Standards) adopted by the Commission. It has extensive information rights, e.g. receiving the annual work programme, the multiannual work programme and the annual reports of the ESAs. The chairpersons of the ESAs and the executive directors have to be confirmed by Parliament. In addition, Parliament may request opinions from the ESAs. Parliament also votes on the discharge of the budget of the ESAs each year. Parliament and the ECB have furthermore concluded an interinstitutional agreement^[1] in order to ensure [accountability](#) and oversight regarding the tasks conferred on the ECB within the SSM framework. In addition, the Chair of the Supervisory Board [presents](#) the ECB's Annual Report on supervisory activities to Parliament, explains the ECB's execution of its supervisory tasks and answers questions from members of the Committee on Economic and Monetary Affairs (ECON).

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[1]2013/694/EU.

