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 aims to ensure consistent and coherent financial supervision in the EU. It includes the European Systemic Risk Board (ESRB), the three European supervisory authorities (EBA, ESMA and EIOPA) and the national supervisors. The ESFS has continuously evolved to take account of the changing context in which it operates, notably the introduction of the Banking Union, the goal of developing a Capital Markets Union and the 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

The financial sector is subject to a strict regulatory and supervisory framework designed to promote financial stability and protect the customers of financial services. EU regulations set out the rules and standards by which financial institutions must abide. Supervision is a process of oversight designed to ensure that financial institutions apply those rules and standards properly. Among other issues, the global financial crisis laid bare the need to improve and strengthen the European regulatory and supervisory architecture. As a result, the EU carried out a number of reforms to overhaul the way in which the EU financial sector is regulated and supervised. 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) — the Joint Committee of the ESAs, 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 that combines micro- and macro-prudential supervision. The main objective of micro-prudential supervision is to oversee and limit the distress of...
individual financial institutions, thereby protecting the customers of those institutions. By preventing failures of individual financial institutions, it also seeks to prevent or at least mitigate the risk of contagion and repercussions for other institutions. 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.

The global financial crisis demonstrated how the EU’s pre-crisis supervisory architecture placed too much emphasis on the supervision of individual financial institutions and too little on the macro-prudential aspects. A bespoke body — the ESRB — was therefore established, and was handed responsibility for the macro-prudential oversight of the EU financial system and the prevention and mitigation of systemic risk. Micro-prudential oversight is performed by the EBA, the ESMA and the EIOPA in each of the relevant sectors of financial services — banking, capital markets and insurance. On cross-sectoral and horizontal issues, the three micro-prudential authorities work together in the Joint Committee.

The establishment of the Banking Union[1] in 2012 introduced new dynamics into the EU regulatory and supervisory framework. It added new elements and actors, such as a single rulebook, the **Single Supervisory Mechanism** (SSM), which became operational in 2014, and the **Single Resolution Mechanism** (SRM), which became operational in 2016. In 2019, a review of the ESFS framework was completed by amending the founding regulations of the ESAs and the ESRB. The amendments aim to reinforce the powers, governance and funding of the ESAs and to strengthen the capacity of the ESRB in overseeing the financial system and detecting risks to financial stability.

**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 ESMA and the EIOPA are EU agencies with their own legal personalities and are represented by their respective chairpersons. The ESAs must act independently and only in the interests of the EU as a whole. They are accountable to Parliament and the Council for their actions.

The primary objective of the ESAs, as defined in their respective regulations, is to protect the public interest by helping to underpin the stability and effectiveness of the financial system. More specifically, 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;

[1]For more details on the Banking Union see below and the factsheet on that topic.
— 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;
— Enhancing customer protection;
— Enhancing supervisory convergence across the internal market.

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). With a view to enhancing supervisory convergence, 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.

In its relevant sector of activity, each of the ESAs, in consultation with the ESRB, is tasked with developing criteria for identifying and quantifying systemic risk and devising an adequate stress-testing regime for the institutions within its purview. The ESAs also initiate and coordinate EU-wide stress tests to assess the resilience of financial market participants. Financial market participants that are liable to pose a systemic risk must then be subjected to enhanced supervision.

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.

Originally based in London, the EBA relocated to Paris in June 2019 owing to the United Kingdom’s withdrawal from the EU. The purview of the EBA encompasses credit institutions, financial conglomerates, investment firms, payment institutions and e-money institutions. With the review of 2019, the EBA was also entrusted with preventing the financial system from being used for the purposes of money laundering and terrorist financing.

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.

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 direct oversight and 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.

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 and financial services; consumer and investor protection issues; cybersecurity; and information exchange between the ESRB and ESAs. The Joint Committee is responsible for the settlement of disputes between the ESAs on cross-sectoral matters.

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.

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)

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.

C. Cooperation at various levels

Financial markets are complex, interconnected and increasingly globalised. Coordination and cooperation between the supervisory authorities in charge of the different entities and sectors, both within the EU and globally, is therefore key. The ESFS founding regulations provide a number of tools and mechanisms for cooperation between the individual supervisory authorities at EU level. In that context, the ESAs play an important coordinating role. The various entities within the ESFS also coordinate with various international institutions — including at supervisory fora such as the International Organization of Securities Commissions (IOSCO), the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS) — and with third-country supervisors.

Development of the supervisory framework

As the financial crisis unfolded, it became clear that merely coordinating financial supervision via the ESFS was not sufficient and that a deeper integration of banking supervision in the euro area was necessary. Consequently, the EU Banking Union was established in 2013, and became operational in November 2014. As one of the Banking Union’s main pillars, the Single Supervisory Mechanism (SSM) is a particularly important element of the supervisory framework.

Under the SSM Regulation, the ECB is the banking supervisor for the largest banks (‘significant credit institutions’) in the euro-area Member States, plus any non-euro-area Member States that decide to join. For this purpose, the governance structure of the ECB has been adapted through the establishment of a Supervisory Board. The tasks of the ECB in that capacity include authorising credit institutions, ensuring compliance with prudential and other regulatory requirements, and carrying out supervisory reviews. The national banking supervisors continue to oversee the remaining banks. In addition to these micro-prudential tasks, the ECB also has macro-prudential tasks and tools at its disposal. In order to ensure consistent supervision, the ECB cooperates closely
with the national banking supervisors within the SSM and with the other authorities that make up the ESFS, most notably the EBA.

**ROLE OF THE EUROPEAN PARLIAMENT**

As co-legislator, Parliament played an important part in setting up the founding legislation for the ESFS. Moreover, it has a scrutiny role as regards the measures adopted in developing the single rulebook, i.e. delegated acts (including Regulatory Technical Standards) and implementing acts (including Implementing Technical Standards). The chairpersons of the ESAs and the executive directors have to be confirmed by Parliament. Parliament also has extensive information rights, e.g. receiving the annual work programme, the multiannual work programme and the annual reports of the ESAs. In addition, Parliament may request opinions from the ESAs. It also votes on the discharge of the budget of the ESAs each year.

Furthermore, Parliament and the ECB have concluded an Interinstitutional Agreement (2013/694/EU) in order to ensure accountability and oversight regarding the tasks conferred on the ECB within the SSM framework. In particular, Parliament decides on the approval of the candidate proposed by the ECB for Chair and Vice-Chair of the Supervisory Board through a vote in the Committee on Economic and Monetary Affairs (ECON) and in plenary. Moreover, the Chair of the Supervisory Board attends regular hearings and exchanges of views with MEPs to present the ECB’s Annual Report on supervisory activities and explain the ECB’s execution of its supervisory tasks, and also answers questions from MEPs.

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