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Directorate-General Financial Stability,
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B-1049 Brussels
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Ref: ESMA's funding model

Dear Ms Albuquerque,

In the course of nearly 15 years, ESMA has established itself as a credible supervisor and delivered on new mandates, while continuing to promote supervisory convergence and strengthen the single rulebook. ESMA has achieved this despite a lack of adequate staffing/funding for its new responsibilities, amplified by inflation-led increases in costs, which have presented a challenge that ESMA has so far met with regular stringent prioritisation and redeployment efforts, and measures to increase productivity. However, over the long-term, a sustainable financial framework is essential to enable ESMA to fulfil its current and future mandates and respond to evolving demands. The Savings and Investments Union (SIU) strategy and ESMA's role within it will be a key driver for the future and it is important that the level of EU funding provided to ESMA in the forthcoming 2028-2034 Multi-annual Financial Framework (MFF) is aligned with it. On behalf of ESMA's Board of Supervisors, I am writing to provide a set of recommendations to bring greater fairness, simplicity and predictability to ESMA's funding model in the long-term, while improving its ability to deliver on its mandates.

From its beginning as the first EU-wide supervisor of financial entities in 2011, becoming the supervisor of credit rating agencies more than three years before the Single Supervisory Mechanism began supervising significant Euro-area banks, today ESMA receives roughly a third of its funding from fees from entities that it directly supervises. However, the growth in ESMA's fee-funded mandates through separate legal acts over time has led to complexity and rigidity in how the model for fee-funded activity works, which limits ESMA's ability to fully operate as a risk-based supervisor. Cooperation between ESMA and the Commission led already to some technical improvements in the five Commission Delegated Regulations on fees applicable from 1 January this year. The objectives of ensuring fair treatment of all supervised entities and consistency over time warrant now taking a second step, in some cases requiring legislative changes.

In particular, key principles should be simplified and consolidated in ESMA's founding regulation, with more detailed rules in a single delegated act on fees, while maintaining a sectoral calculation of fees to ensure proportionality. In addition, minimum fees should be set for each category of supervised firm with no exemptions and no caps to support fairness while being mindful of the full cost recovery principle. For new regulated activities, to avoid creating barriers at entry, fixed amounts could be considered for the first two years. Moreover, preparatory work for new supervisory mandates, such as recruitment/training of staff, developing delegated and implementing acts directly related to supervisory activities and ICT development costs, should be systematically anticipated and covered by the EU budget. Last, further flexibility should be explored to enable ESMA to fully act as a risk-based supervisor with full capacity to allocate resources to where they can be most beneficially utilised, due to new risks arising or unpredictable peaks of activity.

In relation to the remainder of ESMA's budget, whereas the funding models of most EU agencies rely heavily, if not exclusively, on EU funding, a 40/60 ratio of EU/National Competent Authority (NCA) contributions is applied to the European Supervisory Authorities, reflecting a political agreement reached at the time of adoption of the ESA Regulations. The upcoming review of the European Supervisory Authorities and the ongoing negotiations of the MFF provide an opportunity to reflect on the changes needed to ensure the sustainability of ESMA's funding model. ESMA's budget (excluding the fee-funded part) only represents 0.03% of the EU's overall budget. In general, while Member States must continue to provide funding for their NCAs to ensure adequacy of resources for the fulfilment of both domestic and EU mandates, an increase in the support from the EU to a 50/50 parity ratio or beyond would particularly assist the NCAs that face increasing budgetary challenges at national level. Furthermore, additional EU funding should cover the development costs of EU-wide ICT projects that benefit NCAs and EU financial market participants. This would ensure that ESMA's decisions to invest further in new tools and technologies that would foster economies of scale, efficiency gains and ultimately save costs for the European System of Financial Supervision are not competing with individual national budgetary decisions but are taken based on the Union interest.

An additional mechanism for alleviating budgetary pressure on some NCAs is to reconsider the distribution of the NCA share of ESMA's budget amongst the NCAs. The current distribution key is based on the weighting of votes set out in Article 3(3) of Protocol (No 36) on transitional provisions, which is largely population based. An alternative distribution model was previously proposed by the Commission in the context of the 2017 ESA review¹ but not retained. ESMA's Board of Supervisors considered different approaches that may provide for fairer levels of contributions from NCAs, including linking the distribution key to a combination of market size and investor base in each Member State. While different views were expressed by the NCAs, a broad majority supported such a direction of travel while noting that the pros and cons, as well as the exact calibration of any new methodology, would deserve careful consideration. Diverging views were expressed on any possible impact on voting rights – a matter outside of

¹ Commission staff working document impact assessment accompanying the proposal for a Regulation of the European Parliament and the Council, 20.9.2017, SWD(2017) 308 final.

ESMA's competence. Caps on NCA contributions as a percentage of their national budgets were also discussed, with some members in favour and others strongly against, but are eventually not proposed as a majority considered that caps are not fit for ensuring a sustainable funding of ESMA's tasks and missions.

In parallel, ESMA is committed to continuously improving its efficiency. We would welcome additional efforts from the Commission to instil efficiency also by design when proposing tasks for ESMA. This will enable an allocation of resources to those activities that are most effective to strengthen EU capital markets and deepen their integration, while protecting investors throughout the Union. The Board believes that the Commission should consider reducing the number and frequency of ESMA's legally mandated recurrent outputs (e.g. annual reports, annual peer reviews, mandatory reviews of technical standards and guidelines) to allow ESMA to prioritise its resources more freely to identified risks and promote supervisory convergence in the most efficient way. Lastly, based on the good track record ESMA has established as a data hub, a review of the current reporting frameworks is recommended with the objective of eliminating duplications and ensuring a design on data reporting which would benefit all market participants, NCAs and ESMA.

The combination of ESMA Board recommendations, which are set out in the Annex, will help to ensure that ESMA is able to continue to meet its objectives - as well as to be able to discharge any new tasks given to it as part of the SIU strategy - with a revised funding model that is sustainable, forward-looking and fair. ESMA notes that EIOPA, having undertaken an analogous assessment of the limitations of its funding model, will be making a similar set of recommendations to the Commission.

My colleagues and I remain at your disposal to further discuss these matters and answer any question you may have.

Yours sincerely,

Verena Ross

CC:

- Mr John Berrigan, Director General, DG Financial Stability, Financial Services and Capital Markets Union, European Commission

Annex: Recommendations on ESMA's funding model

Recommendations for a fairer and more flexible fee-funding model for ESMA's direct supervision

- Ensure a consistent framework for fees by enshrining key principles in the ESMA Regulation, including the full cost recovery principle as a core principle applying at ESMA level to its activities as a direct supervisor.
- Sector-specific fee calculations should be maintained to ensure proportionate and reasonable fees per supervisory mandate.
- Consistent cross-sectoral fee payment modalities (i.e. such as minimum fees across all mandates without exemption or caps) should be consolidated in a single delegated act to ensure fair treatment of all entities subject to ESMA supervision.
- Full, time-limited EU funding should be provided to cover the preparatory work related to new supervisory mandates.
- Explore further flexibility by design through a multi-annual reserve fund. Alternatively, another tool leading to a similar outcome or an ex-post fee model could also be considered.

Recommendations on the level of NCA funding and distribution amongst NCAs

- To ensure a future-proof approach and alignment with the SIU strategy, any revision of ESMA's funding model should be based on the principles of sustainability, fairness, simplicity and predictability.
- To ensure ESMA's general budget is more stable and sustainable, full EU funding should be provided for certain ICT projects and NCAs should not be called upon to fund ESMA's preparatory work ahead of new direct supervisory mandates.
- To ensure simplicity and sustainability, starting from the new MFF (2028), the current 40/60 EU/NCA ratio should be adjusted based on an increased level of EU funding, towards a 50/50 ratio (or beyond).
- To enhance fairness and accountability, the distribution amongst NCAs of the total amount to be paid by them to ESMA's budget could be based on a new methodology, potentially taking into account the size of domestic markets and investor base within each Member State. The respective pros and cons of any change should be carefully assessed.
- To ensure predictability, any revised distribution key should be set for a number of years, ideally aligning with the MFF duration, and provide for ad hoc adjustments in case of significant changes to ESMA's present and future mandates.

Recommendations for increasing efficiency

- Reduce the number and/or the recurrence of ESMA's legally mandated recurrent outputs, tasks or obligations. For example, annual reports and systematic peer reviews are not always an effective tool to monitor the evolutions in the market and over time produce less added value while diverting NCA and ESMA resources from other more pressing issues.
- Ensure that all Level 2 mandates which are not essential to apply the Level 1 are discretionary ("may clauses") to allow ESMA, together with the Commission, to prioritise issues according to impact and time-sensitivity.
- Refrain from Level 1 empowerments for ESMA to issue guidelines, to allow flexibility to assess what guidance is needed and when it should / can be provided.
- Break down siloes artificially created by the single rulebook: (i) use future reviews to begin merging/consolidating existing acts; (ii) launch a project to harmonise legal definitions and generally applicable requirements (outsourcing, internal controls...) and streamline the number of regulations applicable to financial markets.
- Enhance efficiency of data reporting: (i) based on the good track record ESMA has established on data, a review of the current mandates should be performed with the objective to eliminate current duplications and ensure a design of data reporting which would benefit all market stakeholders, NCAs and ESMA; (ii) where such measure would not be possible, delegation of tasks to ESMA could be envisaged (like for ESAP).