Issues of Legal Uncertainty Arising in the Context of the Use of Q&A Documents by the European Supervisory Authorities

Response to the European Commission's Public Consultation on the Operations of the European Supervisory Authorities

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Financial Markets Law Committee[1]

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[1] Given the role of one or more of the Tripartite Authorities in forwarding questions for a Q&A response and/or in considering any Q&A documents with a view to the implementation of E.U. regulatory policy, Stephen Parker, Sinead Meanie and Sean Martin took no part in the preparation of this paper and the views expressed should not be taken to be those of HM Treasury, the Bank of England or the Financial Conduct Authority.

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1. INTRODUCTION

1.1. The role of the Financial Markets Law Committee (the "**FMLC**") is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2. On 21 March 2017, the European Commission launched a public consultation (the "**Consultation**") seeking views on the operation of the European Supervisory Authorities (each, an "**ESA**"), comprising the European Securities and Markets Authority ("**ESMA**"), the European Banking Authority ("**EBA**") and the European Insurance and Occupational Pensions Authority ("**EIOPA**").[2] Following stakeholder recommendation, the FMLC takes this opportunity to offer a response to the Consultation in respect of one particular tool used by the ESAs to promote a common supervisory culture: question and answer ("**Q&A**") documents. The ultimate aim of this response is the attainment of greater clarity for market participants as regards the use of this tool by the ESAs.

2. BACKGROUND AND EXECUTIVE SUMMARY

2.1. The ESAs currently produce a number of Q&A documents which are intended to provide further clarification on the meaning of E.U. legislation. The ESAs each derive their authority to publish Q&A documents from their respective founding regulation (collectively, the "**ESA Regulations**"), each of which contains similar language permitting each ESA to "develop new practical instruments and convergence tools to promote common supervisory approaches and practices".[3]

2.2. This broad enabling language permits the ESAs to pursue a flexible approach to determine the most effective means to promote common supervisory approaches in their respective fields of competence. In this regard, flexibility is a virtue insofar as the ESA Regulations have not preordained a fixed regime for

[2] European Commission, *Public consultation on the operations of the European Supervisory Authorities*, available here: https://ec.europa.eu/info/finance-consultations-2017-esas-operations_en.

[3] See Article 29(2) of Regulation (EU) No 1095/2010 ("**ESMA Regulation**"); Articles 1(5)(a) & 29(2) of Regulation (EU) No 1093/2010 ("**EBA Regulation**"); and Article 29(2) of Regulation (EU) No 1094/2010 ("**EIOPA Regulation**").

generating Q&A documents, and have instead afforded each ESA the freedom to identify and pursue different methods and approaches. Stakeholder experience of the Q&A process to date suggests, however, that certain methods and approaches appear to be more effective than others. The overall Q&A process, moreover, is characterised by a substantial element of practical and procedural uncertainty, which could be detrimental to participants in the markets supervised by the ESAs.

2.3. This paper, in addition to unpacking the detail of some of this uncertainty, makes recommendations to mitigate uncertainties identified by the FMLC so as to ensure a more consistent approach by the ESAs in fulfilling the mandate set out for them in the ESA Regulations. In the paragraphs below, the FMLC suggests that the ESAs consider introducing certain enhancements to the current Q&A process, as follows: (i) providing greater transparency regarding the internal procedure followed by the ESAs in formulating responses to questions submitted; (ii) agreeing a set of "best practices" to ensure greater consistency in the practical approaches taken by the ESAs; and (iii) clarifying the relationship between the Q&A documents and the guidelines published by the ESAs (the "**Guidelines**"), as well as the interrelationship between ESA publications and the question and answer documents published by the European Commission ("**EC Q&As**").[4] The issues behind these recommendations are discussed at Sections 3, 4 and 5 respectively. These sections are followed by an impact analysis at Section 6, before the FMLC outlines its proposed solutions at Section 7. By way of closing, the FMLC's conclusions are briefly restated in Section 8.

3. PROCEDURAL TRANSPARENCY

3.1. The precise process for the formulation of the ESA Q&A documents is not transparent. While individual pieces of the puzzle can be discerned, such as the final approval of Q&A publications by an ESA's Board of Supervisors, many basic points remain obscure. For example, while ESMA discloses the role of standing committees and consultative working groups,[5] the publicly available

[4] The FMLC observes that these documents are sometimes formulated (and referred to) as "frequently asked questions" or "FAQs", rather than Q&As. It is unclear whether there is a formal difference between these two types of question and answer formats. For the avoidance of confusion, the term "EC Q&As" is, throughout this paper, intended to refer comprehensively to both kinds of format.

[5] See https://www.esma.europa.eu/questions-and-answers.

terms of reference for these bodies are generally very short and do not contain much meaningful detail as to the scope of a given committee's remit or to the role it plays in the Q&A process.[6] These short terms of reference sometimes refer to a separate document, "Procedures for ESMA Groups".[7] This document, however, is not publicly available and so it is not possible to determine what, if any, impact such procedures have on the Q&A process.

3.2. The internal procedures for publishing ESA Q&A documents—in respect of all of the ESAs—can therefore be likened to a "black box". This lack of transparency extends to:

a) the procedures for determining whether a given question should be answered;

b) the procedures (if any) for ensuring that a proposed response does not conflict with another response, whether published or to-be-published;

c) the timeline for considering questions and the routing of proposed replies through specified standing committees, working groups, or similar;

d) whether all questions that are submitted are considered or, if not, the process for exercising the discretion to determine not to answer a question; and

e) the process for exercising the discretion to rephrase or reformat a question.

3.3. Below, the FMLC considers the impact of this procedural uncertainty at Section 6, and proposes potential solutions to resolve this uncertainty at Section 7.

[6] See, for example, the terms of reference for the Investor Protection and Intermediaries Standing Committee: ESMA/2013/BS/45.

[7] "Procedures for ESMA Groups" document reference: ESMA/2011/BS/236.

4. DIVERGENT PRACTICES

4.1. The FMLC observes that each ESA produces Q&A documents in different ways. ESMA produces "accretive" Q&A documents; these documents are published in a pdf format and contain questions which are, it appears, finessed by ESMA, and reformulated so that they are not overly institution- or matter-specific. Answers within the Q&A documents are revised, amended or supplemented by ESMA over time, as necessary.[8] This approach can be contrasted with that taken by the EBA and EIOPA. The EBA makes use of a Single Rulebook Q&A tool webpage, where questions are published by the EBA as submitted, without being reformulated.[9] EIOPA, similarly, appears to publish questions in the form they are submitted, and sets them out in Excel spreadsheets.[10]

4.2. As there is no difference in the language in the ESA Regulations enabling the ESAs to promote common supervisory standards,[11] the observed difference in practice is not the result of legal prescription but, rather, appears to be the product of the specific approaches taken by each ESA over time. As noted at Section 2, above, the FMLC recognises that the freedom to innovate supervisory approaches is beneficial. This Consultation is, however, an appropriate moment to reflect on the characteristics which may distinguish those approaches which have been most useful for supervised entities and whether greater convergence—perhaps through the adoption of "best practices"—is warranted.

4.3. That the adoption of such "best practices" might be beneficial is suggested by a consideration of the heightened potential for legal uncertainty to arise in the context of the approach adopted by the EBA and EIOPA. This is because publishing questions in the exact form in which they are submitted, without careful reformulation, increases the risk of: (i) multiple responses covering a single topic area, which may result in overlapping, and even contradictory, answers; and (ii) responses tailored to specific fact patterns, from which it is

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8 See, for example, ESMA Questions and Answers On MiFID II and MiFIR transparency topics (5 April 2017) ESMA70-872942901-35:https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-35_qas_transparency_issues.pdf.

9 A link to this Single Rulebook Q&A tool webpage can be found here: http://www.eba.europa.eu/single-rule-book-qa.

10 A link to EIOPA's holding page for these Q&A documents can be found here: https://eiopa.europa.eu/regulation-supervision/q-a-on-regulation.

11 See footnote 1, above.

difficult to extrapolate general guidance. The potential impact of these uncertainties is considered at Section 6, and, more generally, potential "best practices" are investigated at Section 7.

As a closely-related point, the FMLC would encourage the ESAs to consider ways in which to improve the quality of the questions submitted in order to facilitate the publication of maximally helpful responses.[12]

5. LEGAL STATUS OF Q&A DOCUMENTS

5.1. The ESAs each clearly state that their Q&A documents are not legally binding. EIOPA includes a disclaimer on its Q&A website stating that answers "are of a non-binding nature" [13] and the introduction to the EBA's Single Rulebook Q&A states that the Q&As "have no binding force in law nor are they subject to 'comply or explain'".[14] ESMA has also recently provided a similar confirmation.[15] The FMLC is aware, however, of some residual issues of legal uncertainty relating to the status of the ESA Q&A documents as compared with Guidelines, and with the EC Q&As.

Guidelines

5.2. Principally, the procedure for promoting topics addressed in ESA Q&A documents to the status of Guidelines is uncertain. As noted at Section 2, above, the ESAs have several tools in their supervisory toolkit to foster and encourage the implementation of E.U. financial services regulation. ESA Q&A documents are, as noted, not legally binding and therefore have the least *de jure* impact on supervised firms. The ESAs also have the power under the ESA Regulations to adopt Guidelines,[16] which are subject to a "comply or explain"

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12 It has been suggested to the FMLC that encouraging stakeholder (i.e. industry) associations to cooperate with one another and with the ESAs in the design of questions would be beneficial. Certainly, from the perspective of consistency, this is hard to contradict. The FMLC is aware, however, that the ESAs would wish fully to reflect on the ethical and legal implications of greater industry engagement. These considerations fall outside the remit of the FMLC.

13 See http://eiopa.europa.eu/regulation-supervision/q-a-on-regulation.

14 See http://eba.europa.eu/single-rule-book-qa. It is not uncommon for a disclaimer to appear in the EBA Q&A documents observing that "only the Court of Justice of the European Union can provide definitive interpretations of EU legislation".

15 See https://www.esma.europa.eu/questions-and-answers.

16 See, for example, Article 16 of the ESMA Regulation.

obligation and have greater legal force than ESA Q&A documents.[17] The FMLC is not aware of any formal (or informal) procedure or process by which an ESA may determine how to advance an issue addressed in a Q&A document so that it is included in a Guideline. For instance, ESMA merely notes that it will keep Q&A documents under review "to identify if, in a certain area, there is a need to convert some of the material into ESMA guidelines".[18] The impact of this uncertainty is explored at Section 6, and the FMLC's recommendations are set out at Section 7.

EC Q&As

5.3. Until last year, the European Commission had historically published non-binding guidance—in the form of EC Q&As—on a variety of E.U. financial services legislation, including measures on the clearing of OTC derivatives,[19] investment services,[20] payment services,[21] and the management of alternative investment funds.[22]

5.4. The EC Q&As were withdrawn in August 2016, on the basis that the proper forum for providing such guidance fell to the ESAs. Since then, however, there has been a partial reinstatement of these documents. The European Commission holding page for the interpretation of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories ("**EMIR**") now has a link to a European Commission frequently asked question document.[23] Similarly, the holding page providing guidance on the implementation of Directive 2004/39/EC on markets in financial instruments ("**MiFID**") has a link to a European Commission Q&A document.[24] Such

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17 The FMLC notes in this regard that there is an emerging difference in implementation of ESA Q&A documents by national competent authorities, some of which imbue the Q&A documents with a "comply or explain" status reserved for ESA Guidelines.

18 See, for example, ESMA, *Q&A Document on the Market Abuse Regulation* (27 January 2017) ESMA70-21038340-40, at p.4.

19 Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories.

20 Directive 2004/39/EC on markets in financial instruments.

21 Directive 2007/64/EC on payment services in the internal market.

22 Directive 2011/61/EU on Alternative Investment Fund Managers.

23 See https://ec.europa.eu/info/law/derivatives-emir-regulation-eu-no-648-2012/implementation/guidance-implementation-and-interpretation-law_en.

24 See https://ec.europa.eu/info/law/markets-financial-instruments-mifid-directive-2004-39-ec/implementation/guidance-implementation-law_en.

reinstatement is, however, not uniform. For example, the equivalent page for Directive 2011/61/EU on alternative investment fund managers ("**AIFMD**") does not contain the European Commission's previous Q&A document on the interpretation of the AIFMD, and only refers to ESMA's Q&A.[25]

5.5. From one perspective, where the EC Q&As have been removed, this has provided "jurisdictional" clarity and removed the uncertainty that might emerge in the event of conflict or overlap between the EC Q&As and ESA Q&A documents. From another perspective, it has resulted in a regrettable loss of important regulatory "jurisprudence" which was providing useful guidance to market participants, thereby enhancing practical and regulatory certainty.

5.6. Moreover, in those cases where the EC Q&As have been subsequently restored, in the view of the FMLC, the following questions could usefully be addressed:

a) the delineation of topic areas reserved to each process and the mechanism by which a "jurisdictional" dispute might be resolved; and

b) the process for resolving any overlaps, conflicts and lacunae that might emerge.

6. IMPACT

6.1. The lack of transparency as regards the internal procedure followed by the ESAs in respect of Q&A documents generates significant uncertainty for those who look to these documents as a useful source of information.

6.2. A particular risk, arising from the practice of the EBA and EIOPA of publishing questions without careful reformulation, is that supervised firms may have to face and, ultimately, take a view on non-aligned, or even contradictory, responses when attempting to comply with E.U. regulation. Moreover, there is the further—perhaps more concerning—risk that where responses are highly tailored to specific fact patterns and regulators and supervised entities are left to extrapolate a wider scope of application themselves, national divergences and

[25] See https://ec.europa.eu/info/law/alternative-investment-fund-managers-aifm-directive-2011-61-eu/implementation/guidance-implementation-and-interpretation-law_en.

unforeseen consequences may emerge. Indeed, the FMLC is given to understand that examples of legal uncertainty stemming from these two risks are already in evidence.

6.3. Finally, lack of clarity as to the precise differences—and interrelationship—between the ESA Q&A documents, Guidelines and the EC Q&As has generated uncertainty for supervised entities seeking to navigate financial services legislation, in particular because the obligation on firms is greater if an issue is addressed in Guidelines as opposed to an ESA Q&A document.

7. PROPOSED SOLUTIONS

7.1. The FMLC takes the view that due consideration be given to the production of guidance, either by the European Commission or the ESAs themselves, in order to provide greater transparency as to the ESA Q&A process. Such guidance should, in particular, seek to address the items identified above at paragraph 3.2.

7.2. As regards the adoption of possible "best practices" by the ESAs in respect of their Q&A documents, the FMLC believes that the following approaches could be considered for adoption across the ESAs:

a) publication of Q&A documents in an "accretive" fashion, where updates are identified and are added to a single corpus of questions and responses;

b) arrangement and publication of Q&A documents on an easily-understood topic or thematic basis, so that national regulators and supervised entities need only consult a single document; and

c) reformulation (within reason) of questions submitted so that they are not overly institution- or matter-specific and, correlatively, so as to avoid overly specific responses.

7.3. Given the differing legal impact on supervised firms where an issue moves from an ESA Q&A document to Guidelines, discussed at paragraph 6.3 above, firms could benefit from greater procedural transparency as to:

a) which personnel, committee or working group is responsible for undertaking the ongoing review of the Q&A documents;

b) the criteria on which such review is based, including any recommendation to include a topic area in a new Guideline;

c) the internal procedure for reviewing any such recommendation; and

d) the body responsible for the final approval of any such recommendation.

Clarification could take the form of information and/or guidance published by the European Commission and/or the ESAs.

7.4. The FMLC is also of the view that this Consultation may be an opportune moment to clarify more precisely the scope of the ESAs' interpretive authority to issue Q&A documents. Such clarification could take the form of an amendment to the ESA Regulations or guidance from the European Commission and the ESAs.

7.5. Finally, the FMLC would be broadly supportive of any move fully to reintroduce the EC Q&As, which previously provided a useful source of regulatory jurisprudence for market participants and their advisors. Moreover, it would recommend that further consideration be given to the delineation of topic areas reserved to the EC Q&As and the ESA Q&A documents, respectively, as well as to the process for resolving any overlaps, conflicts and lacunae that might emerge.

8. CONCLUSION

8.1. This paper has identified and, where appropriate, suggested potential solutions or improvements to issues of legal uncertainty arising out of the use of Q&A documents as a means of legislative clarification by the ESAs. The FMLC has drawn attention to issues of uncertainty relating to: (i) procedural transparency; (ii) divergent practices employed by the ESAs in relation to their Q&A documents; and (iii) the legal status of Q&A documents, in particular vis-à-vis Guidelines and EC Q&As. To address these uncertainties, the paper has

suggested a number of tailored recommendations, including the production of supplementary guidance by the EC and/or the ESAs and the possible adoption of "best practices" by the ESAs.

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