

ESMA Brief - 2016

Review and Compliance Analysis of XBRL/IXBRL Standards and ESEF for Operational Governance and Data Management (governance)

The discussion revolves around setting up a task force between ESMA and the IFRS Foundation for managing taxonomy changes and proposing an operational governance for ESEF. The XBRL and IXBRL standards show various levels of compliance with legislative requirements, emphasizing their utility for data retrieval, access to issuers' info, operational governance, and data reuse. ESMA proposes ESEF should facilitate comparability and analysis of financial reports, easier reporting, and accessibility to information across the EU. Furthermore, ESMA suggests XBRL / IXBRL standards should be implementable, enable governance and control of changes, and allow data reuse. The study concludes that XBRL / IXBRL is generally compliant with transparency directive requirements and the adoption should consider the scenario, rules, and conditions. Governance and data management subgroups have been established to help with the control of data collection and to provide a framework for governance of TRs. Finally, the ISO is identified as a tool to ensure open, transparent standards and robust governance to comply with data reporting requirements.

Selection and Implementation of Inline XBRL Technology for ESEF (technology)

ESMA has concluded that Inline XBRL (iXBRL) is the most suitable technology for the European Single Electronic Format (ESEF), despite feedback suggesting the potential costliness and unsatisfactory nature of XBRL technology. The decision also considers the ease of use and low implementation costs of PDF technology, currently the favored technology for most investors. However, iXBRL retains the essential context for figure analysis in a readable format, which is important for ESEF's application. During an initial two-year implementation phase, tagging will be limited to primary financial statements and basic company information to ease user familiarity with iXBRL. Some responses advocated for a technical study for further validation. ESMA assures that they have conducted a thorough study of iXBRL, including a cost-benefit analysis, before proposing its use for ESEF implementation. The maturity of other technologies, like mark-up PDF, was also cited as a factor in the decision process.

Financial Innovation: Insights into ESMA's Methodology and Strategy (innovation)

ESMA posits that the emerging pool of structured financial information from ESEF will stimulate technological innovation and be freely accessible. This data comes from discussions within BSG members and its technical working group on consumer protection and financial innovation. ESMA has a mandate to monitor and coordinate regulatory and supervisory processes in EU securities markets regarding potential innovative disruptions. ESMA utilizes a Financial Innovation Scoreboard for this purpose. This scoreboard acts as a tool to prioritize and analyze financial innovations, helping to identify which innovations necessitate further analysis and potential response to possible market failures. Despite initial skepticism about quantifying inherently unquantifiable risk factors, the methodology provides a robust basis for discussion. The task of analyzing financial sector innovation possesses unique challenges compared to

other sectors such as commerce or manufacturing.

Advantages of XBRL and iXBRL in Data Communication and Reporting in a Multilingual European Environment (environment)

The European ESMA sees value in the application of XBRL and iXBRL for simplifying business operations and improving data accessibility across the EU. These technological environments improve data comparability, accessibility, quality, and extraction. They also promote interaction with existing technology and reduce reporting burdens. Stakeholders also acknowledge that a standard can be easily integrated into an existing technological environment and that old technology can be reutilised for the new standard. The versatility of these technologies makes them valuable in diverse sectors, including companies of different scales, making a significant impact on financial reporting obligations. Attention is drawn to the influence of factors such as a company's IT investment, knowledge of the technological environment, and opinions about the EU's accounting integration process. The same technology is also valuable in measuring units used in different industries. However, the potential additional cost for issuers in low XBRL-prevalence jurisdictions needs to be considered.

Enhancing Data Confidentiality and Integrity in Trade Repositories (confidentiality)

The European Securities and Markets Authority (ESMA) proposes the use of electronic signatures and data encryption protocols in trade repositories (TRs) as part of measures to ensure data confidentiality, integrity, and protection. These measures are mandated by the SFTR and EMIR regulations. The data exchange between TRs and authorities should be carried out through a secure machine-to-machine connection. Unique trade identifiers and Legal Entity Identifiers (LEIs) should be initially exchanged to maintain confidentiality. ESMA highlights the need for clear separation of functions between authorities, accurate reflection of responsibilities and mandates, and reducing risks of data misuse. These measures are viewed as important to fulfil their responsibilities, mandates, and ensuring confidentiality. The authority's own internal procedures will address any confidentiality aspects. Proposals include an adherence system for the TRs to deal with cyber-attacks and to maintain data integrity. Confidentiality concerns were addressed in the context of collateral reporting as part of securities financing transaction reporting (SFTs). ESMA acknowledges these concerns but believes that publishing data on a weekly basis should not compromise counterparty confidentiality.

XBRL International Specifications and Internal Control Structure for Benchmark Administration (accountability)

XBRL International has published recommendations to promote consensus, fairness, accountability, and quality. The compliance can be addressed by administrators of non-critical or non-significant benchmarks. The third country administrators' authorization or registration and recognition are issues addressed in the technical standards. Organizational structure, governance framework, conflicts of interest, internal control structure, oversight, and accountability are main components in these specifications. Followed in different perspectives, including financial information, oversight function, control framework, accountability framework, and transparency of methodology. The registration requirements include providing policies and procedures for monitoring benchmark provision activities, policies for managing various risks and related mitigation measures, incident management, and appointing, substituting, or removing the key

functionaries. The internal control system's robustness will be evaluated by the competent authority to achieve accountability.

Furthermore, non-significant benchmarks substitute detailed provisions with a synthetic description of the internal control structure, oversight, and accountability framework, and the benchmarks provided.

ESMA's role in delivering its objectives and annual work program is ensured by maintaining clear management accountability and proper oversight of the internal control system. The report also emphasizes ESMA's consultation with interested parties regarding regulatory amendments for transparency and accountability maintenance. Maintaining a balanced proportion of different stakeholders is key to achieving transparency and accountability. The provided opinions and advice help maintain the transparency and the accountability required for ESMA's effective functioning.

Analyzing Modern Business Models and Reporting Standards (business model)

Stakeholders hold the perspective that the electronic reporting format, XBRL, is a 'closed standard' because it doesn't accommodate Alternative Performance Measures (APM) and vital qualitative data necessary for comprehending a business model. They differentiate business models and pricing in desktop bolt-on approaches, typically license-based, and the cloud solution, which allows flexible user and filing charges. The report highlights shifting in business models and market structures due to the UK decision in the mid to long-term and changes in dealers' market-making capacity due to risk aversion. Distributed Ledger Technology may alter post-trading models. Global, local, and intermediate business models are evident, with proxy advisors offering subsidiary services like voting logistics and governance-linked research. Adjustments in dealer business models, regulatory reforms, electronification, and bond holding concentration appear in EU corporate bond markets due to the financial crisis. The birth of synthetic prime brokerage mirrors banks' attempt to pivot from physical financing because of new trading environments and regulatory demands. A company must understand the market operator's various components, including business models, risks, activities and the regulatory environment. The text further discusses the need for customized regulations to cater to unique business models and the importance of considering product nature and potential client conflicts in the business model.

Adoption and Consistency with International Standards in the EU Financial Market (international standards)

The XBRL International Standards Board (ISB), along with the ESMA, advocate for harmony with international standards system-wide, including the recent CPML_IOSCO proposal. Trade repository registration applicants are required to provide comprehensive company financial information in alignment with international accounting standards. Additionally, the financial statements should undergo a statutory audit, including the auditors' details. Both ESAS and ESMA aim to maintain conformity with international standards to prevent regulatory arbitrage, reduce the risk of over-reliance, and ensure a harmonious implementation at EU and global levels. Emphasis is placed on measures to reduce costs without compromising sound risk management and keeping proposals aligned with international standards, setting a minimum margin threshold for trade, and adjusting add-on factors for mark-to-market methods in line with international standards.

Methodologies for Measuring Credit Risk and Conflict of Interest Management (objectivity)

Currently, there is no universally applicable method to measure credit risk due to the variations in different PRIIPs. Credit ratings are presently seen as the most proportionate approach balancing objectivity with practicality. Therefore, the development of detailed methodologies is crucial. Proper monitoring of the summary risk indicator's effectiveness and its contribution to market and credit risk will also be necessary.

In order to maintain objectivity, independent members can play a role in overseeing the benchmarks. To manage potential conflicts of interest, strict policies need to be in place. These include the obligation of members to avoid activities that could create conflicts of interest, rigorously review and approve certain activities to prevent conflicts, promptly disclose any conflicts, and managing transactions with related parties on an arm's length basis. Furthermore, a system of how to handle non-compliance needs to be established. Such strict guidelines would ensure that the member's ability to function without compromise and a conflict of interest is minimized.

Strengthening Organizational Ethics and Conflict of Interest Policy at ESMA (ethics)

ESMA has established a robust policy on conflict of interest and ethical conduct amongst staff. Central to this is the code of good administrative behaviour, decision on professional secrecy, and the availability of a practical guide on ethics to all staff. It has set in place an Ethics Officer and Deputy to foster in-house expertise, with an intranet page assisting staff on ethical considerations and issues of potential conflicts of interest. Policies implemented also cover key areas such as financial circuits, recruitment procedures and reporting exceptions. Furthermore, the long-term strategy integrates a multi-faceted approach involving business strategy, risk tolerance, involvement with investors and measures to mitigate conflicts of interest. The framework also addresses monitoring changes impacting financial reporting and auditing, and compliance with international auditing and ethics standards. All staff are required to assert their understanding and compliance with the code of ethics, ensuring their ability to meet regulatory, legal and organizational standards.

Essential Requirements for Trade Repository Registration and Managing Anti-Fraud Measures (fraud)

The application for trade repository registration needs comprehensive personal and professional details of every member of senior management and board members. This includes their curriculum vitae, criminal conviction details related to financial or data services, fraud or embezzlement, and self-declaration of good repute in relation to the provision of a financial or data service. Individuals should also disclose any potential conflict of interests and details of their previous involvement in undertakings which faced regulatory penalties, insolvency or sanctions related to fraudulent activities.

To counter fraud, the European Securities and Markets Authority (ESMA) management board approved terms and conditions for internal investigations in coordination with the European Anti-fraud office (OLAF). Additionally, ESMA adopted an anti-fraud strategy aimed at enhancing prevention, detection, investigation, and sanctioning of potential fraud cases. To assess the honesty and integrity of existing or prospective management body members, market operators and Data Reporting Services Providers (DRSPs) are advised to consider similar factors and request specific documents set in the technical standards on authorisation. Any fraudulent behavior or deliberate misinformation among market participants that threaten orderly markets are to be addressed promptly.

Trade Repository Registration Requirements and Market Concerns on Bond Liquidity (going concern)

The trade repository applicants must provide documentation detailing their business continuity plan, methodologies for identifying and mitigating risks and assessing their financial sufficiency to withstand potential business losses for a six-month period. In addition, ongoing concerns on bond markets are identified, with specific focus on lower liquidity and increased credit risk premia that could potentially trigger a market correction. The bond funds return volatility remains lower than equity funds, indicating continuous concern over potentially reduced liquidity levels in bond markets.

Streamlining Internal Controls and Staff Qualifications in Trade Repository Registrations (internal controls)

ESMA has proposed the removal of the reference to an internal review function in trade repositories, reasoning that this review function is more relevant for credit rating agencies. The provisions regarding internal controls are being specified elsewhere. In the application for registration, necessary information on the staff's qualifications, roles, training and development relevant to the business must be included. Special emphasis is on those with IT education and experience. Past market integrity incidents reveal an urgency for improved transparency, robust internal controls, detailed supervision, regulation and avoidance of conflict of interests. ESMA has been striving to achieve international control standards and foster stakeholder relationships through reorganizing and creating a new department. It argues that the primary responsibility to establish effective internal controls lies with each individual central counterparty.

Stakeholder Engagement and Revisions in International Auditing Standards (international audit)

Discussion regarding the auditor's responsibilities and their scope in relation to xbrl tags as presented by the International Auditing and Assurance Standards Board (IAASB) is of key interest. Broader stakeholder participation, especially from users, is deemed necessary in these discussions to fulfill their needs and enhance audit standard development. The ESMA work programme will carry out related activities, such as monitoring developments impacting financial reporting and auditing, promoting supervisory convergence, and contributing to the EU single rulebook's completion for financial markets. Key contributions include preparation of draft regulatory technical standards, responding to announcements from IAASB, and providing a securities regulator perspective in numerous areas, such as accounting standards, audit regulation, and corporate reporting.

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