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ESMA Brief - 2018

ESMA's New Disclosures and Mandates with Balancing Investor Needs and Issuer Administrative Burdens (nist)

The European Securities and Markets Authority (ESMA) emphasises the importance of the issuer's non-company roles in relation to investor decision-making. Concerns were raised about the balance between issuers' administrative and financial burdens and investors' needs for understandable and accessible information. The disclosure requirement for administrators of benchmark in ESMA register will be removed from the retail and wholesale debt and derivative securities as it leans towards administrative burden for the issuer. The changes in the prospectus review are meant to lessen administrative work and improve the transparency and disclosure of prospectus information. Some suggestions like removal of public domain information and excessive administrative details were also proposed to reduce administrative burden. Meanwhile, ESMA disagreed with the mandatory inclusion of certain items, citing increased administrative costs and low added value to investors. The regulation aims to reduce the administrative burden for issuers, especially SMEs and repeated issuers, while keeping the prospectus useful for potential investors. Ultimately, the commission should consider investor protection, transparency, proportionality, financial market innovation, administrative burden reduction, and easy access to capital markets when using its delegated powers.

Corporate Governance and Financial Impacts Discussion (governance)

A new requirement to disclose potential substantial impacts on corporate governance is widely deemed valuable to investors. Some clarification on terms such as 'material impact' and interpretation of corporate governance is necessary. ESMA maintains the necessity of such disclosures but rejects the need for non-financial information like ESG items in wholesale prospectuses, unless they contain material information. Certain provisions related to the issuer's prospects, significant changes in financial positions, and others were proposed to be eliminated. The need for corporate governance information in the issuer's annual report for secondary issuance is debated. ESMA agrees to the elimination of this requirement from the secondary issuance regime to avoid cost and administrative burdens. Integration of ESG considerations into ongoing regulation is being considered. Emphasizing quantifiable risk factors and giving an overview of key management members is deemed important for investors, leading to a proposal to separate issuer management information from corporate governance data.

ESMA Recommendations on Disclosure of ESG Information and Prospective Regulation Structure (environment)

The ESMA suggests that non-financial information, such as Environmental Social and Governance (ESG) items, need not be published in wholesale prospectuses unless required by the issuer. It recommends strengthened disclosure on sustainability issues while acknowledging that this may not be relevant for all SMEs. Stakeholders propose various changes to prospectus structure, including more prominent risk factors and removal of certain items. Additionally, it implies that non-financial key performance indicators might be included in the business analysis where relevant. The ESMA does not require mandatory inclusion of some details in the

EU growth registration document and outlines the proposed components and order for an EU growth prospectus.

Interest in Enhanced Sustainability Disclosure for Green, Social, and Sustainability Bonds (sustainability)

Many believe that the use of proceeds from green, social, and sustainability bonds should be prominently and detailedly disclosed. This is in alignment with the aim of ESMA and the European Commission to promote sustainable finance. Suggestions include expanding additional information to disclose any proceeds for sustainability, listing specifications, ECB eligibility, selling restrictions, and additional disclosures required by legislation. Apart from a few institutional investors considering these factors in their decisions, the sustainability report of the issuers would provide more information. While not all are in favor of adding more types of specialist issuers, some suggest considering issuers compliant with specific bond principles. Despite the recognition that not all small and medium enterprises need to disclose sustainability, ESMA notes that even smaller companies may pursue sustainability initiatives. Lastly, robust measures to manage financial risks associated with climate change, resource depletion, environmental degradation, and social issues; and fostering transparency and long-termism in financial and economic activity are recommended. It is also suggested that adapting processes and systems to reflect sustainability risks will help build technical capacity and knowledge to analyze such risks.

Integration of ESG Considerations in Compliance and Advisory Process (esg)

Non-financial information (Environmental, Social, and Governance or ESG aspects) is not mandated to be included in wholesale prospectuses, with some specific securities exceptions. Issuers will, however, have the option to include ESG elements voluntarily. ESMA suggests to incorporate ESG considerations in organizational requirements, risk management, and conflict of interest topics, without imposing more obligations on smaller issuers. This principle-based approach implies that firms are expected to integrate ESG considerations within their processes, systems, and controls, thus ensuring that the investment and advisory process takes them into account effectively. While the plan is to prevent misrepresentations and misselling practices, it allows for identification of target markets with or without ESG preferences. Manufacturers and distributors are advised to consider the ESG preferences while identifying target markets for their financial instruments.

Technological Advancements Impacting Financial Services (technology)

The European Securities and Markets Authority (ESMA) is advocating for technological advancements to streamline the process of representing debt security holders and sharing information, addressing the underutilized incorporation by reference in prospectus requirements. Regulatory tech and supervisory tech innovations are enhancing with the use of machine learning. The financial services are seeing transformations as a result of fintech that are favorable for end users. However, the cross-border nature of technology poses regulatory and supervisory challenges requiring coordinated international responses. Secure protocols enabled by distributed ledger technology applications in securities markets are gaining traction in post-trade scenarios. Firms like the ASX and SWIFT are using technology like DLT to improve functions like shareholding records, clearing, settling equity transactions, and corporate actions processing. Moreover, platforms employing blockchain technology, like iznes, are already conducting live transactions. The increased application of tech is also observed in equity-based crowdfunding, especially in technology, real estate, and E-commerce companies. To support financial supervision, national authorities are also incorporating new technology.

Impact of Emerging Financial Technologies on Market Performance and Regulations (innovation)

The new regulations emphasize vital principles the commission should take into account, such as investor protection, market transparency, proportionality, innovation, reduction of administrative burdens, and smoother access to capital markets, including SMEs. There's an evolving nature of benefits and risks associated with RegTech and SupTech innovations. Notably, Fintech continues to be a key driver of innovation with significant potential implications for end-users and service providers. There's on-going monitoring of financial innovation and product trends through ESMA's innovation scoreboard, highlighting innovations like crowdfunding and VIX exchange-traded notes. However, these innovations introduce new challenges and potential risks. The nascent crowdfunding industry, despite its potential benefits, still remains in its infancy in the EU. ESMA adopts a balanced approach to innovation, assessing economic functions, potential benefits, and risks, while understanding how they interact with existing regulatory frameworks. The methodology focuses on investor protection, financial stability, and market integrity. The future of these innovations is unpredictable even as they hold many potential benefits and risks. Technologies like machine learning are central to various RegTech and SupTech innovations.

Ensuring Confidentiality in Data Management and Compliance with National and Union Law (confidentiality)

Various stakeholders have expressed concerns over the confidentiality of data in the issuance and reporting process of securitizations. They must comply with national and union laws protecting confidentiality and personal data to avoid breaches. Some jurisdictions prevent data retention of past financial difficulties of individual obligors. Respondents suggested a 'no data' option reflecting a confidentiality requirement. ESMA removed certain fields viewed as problematic for maintaining confidentiality. Importance has been placed on excellent data availability, confidentiality maintenance, and data quality. Securitisation repositories should use data encryption and electronic signatures to guarantee data confidentiality and integrity. Entities should assure the same level of confidentiality requirements, irrespective of location. Criticisms underline the need for rating agencies to uphold confidentiality obligations and maintain lists of individuals who have access to credit ratings, rating outlooks or related information before public disclosure. Additionally, changes in credit rating methodologies or models should be communicated immediately and treated with the same importance as maintaining confidentiality to avoid disparities in different jurisdictions on inside information treatment.

Comprehensive Understanding on Regulations, Operational Risks, and Fraudulent Offences in Financial Market Operations and Crowd Funding Platforms. (fraud)

People hold a keen interest in understanding the legal, managerial, and operational aspects of companies, notably in relation to fraudulent offences and official public incrimination over the past five years. It's necessary to defines the relationship between fraudulent offences and bankruptcies; and how it concerns with the person in managerial, administrative or supervisorial bodies. The report indicates the increasing risks of fraud associated with investing through crowdfunding platforms. Furthermore, the high failure rate of businesses that hold ICOs, and the resultant structural risk merit prioritization in risk monitoring. Concerns about violations of investor best interests alongside market misconduct and abuse are also highlighted. Legal aspects in relation to professional obligations, decisions in disciplinary proceedings and civil proceedings, management of businesses, registration or authorisation withdrawal, etc. were also of interest. Finally, the growing trend in complaints related to fraud schemes, and the vital role of implementing effective anti-fraud measures and conflict of interest management was discussed.

Preparation for GDPR and Information Exchange Enhancement. (gdpr)

ESMA and IOSCO collaborated to prepare for the forthcoming GDPR implementation and to maintain the exchange of information, including personal data. This joint co-operation yielded widespread agreement that new legislation, including GDPR, would mitigate risk. While some believe that the GDPR provides sufficient framework for big data, others suggest that further guidance on GDPR implementation is required to cater to the financial industry and consumer needs. The GDPR will apply to all service providers processing EU individual's data, introducing the principle of data portability and service neutrality. Increased requirements for data accuracy and protection may potentially address data accuracy related risks. Despite some respondents believing that existing legislation addresses cyber risk management, there remains debate on whether GDPR rules on personal data use in automated decision-making will successfully mitigate risk. The implementation of legislation such as GDPR will be further strengthened by several key legislation pieces entering application in the financial sector.

Regulatory Compliance and Internal Control Measures for STS Assessment Service Providers (internal controls)

ESMA emphasizes that providers of Simple, Transparent, and Standardised (STS) assessment services should have detailed internal controls and policies to ensure the integrity and independence of their assessments. These controls and procedures should include pricing guidelines, cost recording methods, criterias for changing fees, and processes to monitor compliance and update pricing policies and costing systems. Providers should also have transparent procedural controls over fee schedules and individual fees.In addition, ESMA highlights the need to adapt to sustainability risks and incorporates this focus into the criteria used to identify significant internal control system weaknesses. Furthermore, the providers' staff involved in securitisation repository services should be adequately trained and qualified, with clear details about roles, qualifications, and any outsourcing arrangements.For transparency, ESMA requires providers to provide annual reports detailing their internal controls, independence, and potential conflicts of interest. In the case of outsourcing, specific conditions should be met to ensure it does not impair the quality of the providers' internal controls or hinder regulatory supervision. ESMA also necessitates providers to maintain a robust IT strategy and recommends implementation of disaster recovery and business continuity plans. Reporting requirements and timelines are set, and potential non-compliance cases should be promptly reported. Lastly, ESMA considers receiving comprehensive information about the provider's organisational ownership, structure, and ancillary services crucial to understand the applicants' internal controls and ability to comply with regulatory requirements.

Assessing Proposed Financial Reporting Models for Better Issuer Characterization (business model)

Majority of the respondents agree that the new approach would lead to a deep understanding of the issuer's information and business model, thereby enhancing their unique characteristics. Core items to be disclosed in the prospectus will include business model, market features, business strategy, performance overview, offering reasons, and use of proceeds. Additional recommended disclosure items are statutory auditors, capital resources, conflicts of interest, interim finance, cash flow statements, and material contracts. Respondents suggest greater emphasis on the business model and markets where the issuer operates. Allowing issuers to disclose industry-specific KPIs and adjusting disclosure rules would provide needed flexibility, accounting for differences in business models. Firms involved in ICOs are to comply with several financial directives, given their varying business models and token features. Many respondents back a less prescriptive approach that tailors key financial information in the summary to the issuer's business model and operations. The new endorsement approach by ESMA is said to potentially impose additional costs on endorsing credit rating agencies (CRAs), with costs depending on their business model complexity. The MREL set by resolution authorities will be determined by the institution's size, business model, funding model, risk profile, and failure's potential impact on financial stability.

The Impact and Growth of Fintech in Financial Services (fintech)

Fintech is a significant force in financial service innovations, transforming how markets and participants operate and presenting potential benefits to end-users. Developments such as VCs, ICOs, DLT, Regtech, and crowdfunding stand out in this revolution. This change prompted the European Commission's proposal for an EU regulation on crowdfunding to support the development of the pan-European crowdfunding industry. The pace of financial innovation saw a significant increase in 2017, thanks to financial technology. The European Commission and ESMA have positively received these developments, expecting them to enhance customer experiences and financial inclusion. A 2017 fintech-focused Financial Innovation Day held discussions on fintech's future, its role in consumer experience improvement, and key areas like AI, big data, and DLT. However, challenges exist in the rapid tech advancement, impacting various sectors. Big data impact presents opportunities for cooperation among fintech companies and financial institutions, although concerns over regulatory arbitrage and unfair competition between regulated financial institutions and fintech start-ups have been raised.

Audit Regulation Compliance for Financial Statements (auditing standards)

The information focused on the importance of thorough auditing and compliance to audit regulations in different circumstances such as if respective regulations do not apply. Historical financial information should be audited to ensure it offers a true and fair viewpoint, conforming to auditing standards of a member state or an equivalent. The registration document must include a clear statement indicating the applied auditing standards and any significant departures from international standards. Any audit reports on annual financial statements or historical financial information with qualifications, modifications, disclaimers or matter emphasis need to be fully reproduced and reasons provided. An exempted document should also include the respective information if the audit directive doesn't apply.

Advancing IT Security and Cybersecurity: A Critical Review on ESMA's Progress and the Consequences of Cyber Risks (cybersecurity)

ESMA has made significant strides in digitalizing administrative functions through paperless and e-administration tools. Major progress has been reached in IT security, cybersecurity, and business continuity, particularly crucial in an increasingly risky environment. Requests varied widely, spanning from investors' registers, rental contract details, to complaints against registered CRAs. Cyber risks are a primary concern for consumers and market players due to the sensitive nature of processed data and potential severe consequences of cybersecurity breaches. Under the EU cybersecurity strategy, essential service providers are legally required to manage security risks and report any serious incidents. There is currently extensive legislation on data protection and cybersecurity intending to mitigate risks and ensure financial institutions' compliance.

Audit Compliance and International Standards in Business and Finance (international standards)

The material discusses the necessity for businesses to prominently disclose the auditing standards used in their operations. It emphasizes that any major deviation from international auditing standards must be clearly explained. It also stresses the importance of historical financial information being audited systematically. In case any audit reports contain obscurities, modifications, or disclaimers, they must be fully reproduced and justified. The role of risk assessment and the adherence to key international standards such as IOSCO, BIS, and BCBS are also highlighted. For securitisation repository registration, it is mandatory to provide detailed financial and business information, including a set of financial statements compliant with either international or local accounting standards. The trend towards creating a unified rulebook for EU financial markets through high-quality accounting standards and the implementation of single electronic reporting format for issuers listed on regulated markets is noted. It also covers the role of ESMA in providing views on relevant audit standards and ensuring the proper implementation of audit requirements.

Analysis of the Impact of Short-selling Bans on Different Companies (dei)

There is an increasing occurrence of companies having more than one short-selling ban imposed by NCAs (National Competent Authorities). Notable companies include Banco Popolare, BCP, Banco Espirito Santo, Monte dei Paschi, Portugal Telecom, and Saipem. A comprehensive analysis of temporary short-selling restrictions, correlations between company returns and equity benchmarks, and returns on prices during estimation windows for these companies and others are presented. Exceptions in some cases, like overlapping bans, are taken into account. It is significant to note that there are increased notifications for shares subjected to multiple bans and Monte Dei Paschi has had the most number of bans. The overall findings reveal the impacts of these imposed bans and short-selling restrictions on the companies' performances.

Guidelines and Requirements for Securitisation Repository Registration (going concern)

The passage discusses risk factors relating to the registration process for a securitisation repository. Applicants are required to provide a comprehensive description of resources available and procedures aimed at mitigating operational and any other significant risk. Documentation such as relevant policies, methodologies, procedures, and manuals should be submitted. A summary of liquid assets funded by equity intended to cover possible business losses to ensure continued service provision is necessary. Applicants should evaluate their financial resources' adequacy to cover operational costs during a nine-month wind-down or reorganizational phase. An updated business continuity plan containing critical processes, systems, outsourcing services, and changes to the capital structure impacting the company's sustainability must also be outlined. The necessary measures comprise ongoing challenges, particularly when the underlying exposures have originated from entities that have stopped operating.

The Implications of Big Data Analytics in Finance (data analytics)

The joint committee focuses on big data, analyzing its potential benefits and risks to consumers and financial institutions. Companies integrating data analytics with information from securitisation repositories achieve their products' enhancement. The output of big data analytics is substantially influenced by the extent and quality of information consumers provide. However, consumer organisations note that financial big data analytics might intrude into personal life, influencing various aspects, from driving habits to daily health routines. Nevertheless, big data analytics can bring benefits in risk mitigation and prevention, especially when complying with legislation. Majority views AI as an addition to big data analytics to enhance data pattern discovery, evaluation, and prediction. Regulatory articles stress the need for firms' complaints handling processes, impacting how big data analytics' usage influences consumer outcomes.
