



Journal of Financial
Supervisors Academy

Regulatory and Compliance Insights

Publication Date: 1st September 2025

Volume 01

ISSN: 3104-4948
e-ISSN: 3104-4956





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Publication Date: 1st September 2025

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This volume, titled "**Regulatory and Compliance Insights**", focuses on the significant progress and ongoing challenges in the field of financial regulation and compliance. The articles are organized to cover key themes such as, capital markets, independence of financial supervision, digital transformation, and capacity building, reflecting the comprehensive approach needed to address the dynamic nature of financial markets.



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Professional Insight

Independence of Securities Regulators

Nathalie Piscione



Author's Bio



Nathalie Piscione is a Senior Legal Officer at the European Securities and Markets Authority (ESMA) since 2011. She currently works on Supervisory Convergence matters in the Conduct, Supervision and Convergence department. She focuses on topics such as Supervisory Independence, Outsourcing, Peer Reviews. Nathalie previously held senior positions as Legal Counsel, Cooperation Officer and Policy officer at ESMA. Prior to this, Nathalie was Head of Legal in international financial institutions and firms.

Abstract

The EU regulation has granted to the European Supervisory Authorities (ESAs) the task to foster and monitor supervisory independence. This follows the observation that supervisors are subject to pressures while ensuring supervisory independence is a key factor in protecting investors and fostering confidence in financial markets. In that context, the ESAs have published the joint ESAs criteria on the independence of supervisory authorities to provide guidance on supervisory independence. This paper presents the approach adopted by the ESAs to prepare the criteria. Then, it focuses on some of these criteria that extend beyond the international standards and are particularly relevant to foster supervisory independence. Such criteria relate to the good functioning of the supervisor's governing body, the avoidance and management of conflict of interests and transparency. Finally, the paper concludes with the next steps, such as the guidelines on independence that EBA is tasked to prepare and the expected ESAs' assessment of supervisory independence.

Independence of Securities Regulators

Received (in revised form): 11th October 2024

Introduction

Following the review of the European Supervisory Authorities (ESAs)¹ regulation in 2019, the European Securities and Markets Authority (ESMA) together with the other ESAs is required to foster and monitor National Competent Authorities' (NCAs) supervisory independence.² This new task adds to the already existing assessment of the degree of independence of the NCAs in the peer reviews ESMA and the other ESAs conduct.³

Supervisory independence is key to efficiently protect investors, foster confidence in financial markets and attract investments. However, as noted by the OECD, "a variety of pressures are placed on regulators"⁴ by governments, politicians, supervised firms, interest groups and may put at risk supervisory independence and therefore supervisory efficiency. For instance, in the aftermath of the 2008 global financial crisis, the Financial Stability Board (FSB) noted a "high incidence of failure in the IMF-World Bank FSAP assessment" related to independence and considered that "reinforcing the operational independence of supervisory agencies is critical to ensuring supervisory effectiveness

1 The ESAs are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

2 [Regulation \(EU\) N. 1095/2010, art 8.1\(b\)](#); [Regulation \(EU\) No 1093/2010, art 8.1\(b\)](#); [Regulation \(EU\) No 1094/2010 art 8.1\(b\)](#).

3 [Regulation \(EU\) No 1093/2010, art 30.3](#); [Regulation \(EU\) No 1094/2010 art 30.3](#); [Regulation \(EU\) N. 1095/2010, art 30.3](#).

4 *Being an independent regulator* (OECD Publishing 2016) ch 2, 'Why does independence matter? The view from the literature'.

and credibility in general.”⁵ More recently, in November 2020, ESMA identified in a peer review “a heightened risk of influence by the Ministry of Finance given the frequency and detail of reporting to the Ministry of Finance in the Wirecard case.”⁶

In this context, fostering and monitoring supervisory independence is an important addition to the role of the ESAs. Indeed, supervisory independence is instrumental to achieving effective and efficient supervision and consistent application of EU rules across the Union. It also supports a level playing field of high-quality regulation, supervision, enforcement, and hence supervisory convergence. Therefore, to tackle this additional responsibility, each of the ESAs conducted a stock-take exercise on NCAs’ independence. Working in close coordination with each other, they published their respective sectoral reports on the same day, on 18 October 2021.⁷

For this stock-take exercise, ESMA prepared a questionnaire for NCAs building on its experience in using the IOSCO Objectives and Principles of Securities Regulation (‘Principles’)⁸ and their interpretation provided in the IOSCO Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation (‘Methodology’)⁹. In particular, due to the absence of specific EU legal requirements specifying NCAs’ independence definition, ESMA relied on the chapter of the ‘Principles’ dedicated to regulators. This chapter provides that “the Regulator should be operationally independent and accountable in the exercise of its functions and powers”¹⁰ and that “the Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.”¹¹

Based on NCAs’ responses, ESMA found that “NCAs’ independence is multi-faceted” and noted that although “first enshrined in [national] legislation and institutional design, it is also how NCAs operate on a day-to-day basis through their activities, decision-making, and stakeholder engagement, which embeds the culture of independence and the achievement of good regulatory outcomes.”¹² In view of this conclusion and noting that EIOPA already adopted criteria on NCAs’ independence in September 2021,¹³ ESMA together with EBA and EIOPA considered useful to provide further guidance to NCAs to foster supervisory independence.

The aim of this paper is to share the ESAs’ approach to develop the joint ESAs’ criteria on independence, to focus on some of them that are particularly relevant to foster supervisory independence before concluding with the next steps.

5 FSB, *Intensity and Effectiveness of SIFI Supervision: Recommendations for Enhanced Supervision* (2 November 2010) ch II.2, ‘Independence’.

6 *Fast Track Peer review on the application of the Guidelines on the enforcement of financial information by BaFIN and FREP in the context of Wirecard* (ESMA 42-111-5349) para 10.

7 <<https://www.esma.europa.eu/press-news/esma-news/european-supervisory-authorities-publish-sectoral-reports-supervisory>>.

8 <<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD561.pdf>>.

9 <<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD266.pdf>>.

10 Principle A 2.

11 Principle A 3.

12 ESMA, *Report on the Independence of National Competent Authorities* para 8.

13 EIOPA, *Criteria for the Independence of Supervisory Authorities* (EIOPA criteria).

01

The ESAs' approach to developing the independence criteria

Following the 2021 stock take on NCAs' independence conducted by each of the ESAs, it appeared clearly that further work related to this topic needed to be conducted, in close cooperation between the ESAs. In addition, not only the founding regulation of the three ESAs was updated in 2019 with the same new task to foster and monitor supervisory independence as already mentioned, but some ESMA members are also a member of EBA and/or EIOPA. Finally, the approval of the same criteria by each of the three ESAs' Board of Supervisors ensures the relevant focus on supervisory independence. With that background, in 2022, ESMA, EBA and EIOPA agreed to closely work together to develop joint criteria on supervisory independence.

In October 2023, building on international standards,¹⁴ the ESAs published their joint independence criteria.¹⁵ Although non-binding, they are expected to be practically implemented under the NCAs' relevant legal frameworks. As such, they are a very solid basis for NCAs to support and strengthen their independence. Indeed, NCAs can use them for internal discussions but also externally, for instance in discussions with the relevant ministries. In addition, the ESAs can consider the criteria as a benchmark to assess the level of independence of the NCAs, identify good practices to inspire other NCAs as well as potential weaknesses to be addressed.

To develop the joint ESAs' independence criteria, ESMA together with EBA and EIOPA, decided to build on the 2021 EIOPA criteria,¹⁶ keeping the same structure. So, they are organised around the same four chapters i.e., operational, financial, and personal independence as well as accountability and transparency. This structure ensures the continuity with the EIOPA criteria. It builds also on the IOSCO Principles that stress the need for NCAs to have operational independence¹⁷, a stable and sufficient source of funding to exercise its powers,¹⁸ to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed, or otherwise managed¹⁹ and to be accountable.²⁰

Finally, as the joint ESAs criteria aim to provide further guidance to NCAs, the level of granularity of the criteria was carefully considered so they reach a good balance, accounting for the different types of organisational structures of NCAs. For that purpose, the criteria were drafted using a principle and outcome-based approach. Indeed, it was important for the ESAs to focus on the results to be achieved and not on prescribing ways to reach them. As different organisations and systems exist in the EU, depending on the history and choices made in each member

14 BCBS, *Core Principles on Effective Banking Supervision* Principle 2; FATF, *Recommendation 26*; IADI, *Core principles for effective deposit insurance systems* Principles 2, 11; IAIS, *Insurance Core principles* Principle 2; IOSCO, *Objectives and Principles of Securities Regulation* Principles 1-8.

15 *Joint European Supervisory Authorities' criteria on the independence of supervisory authorities* (JC 2023 17 – 25 October 2023).

16 EIOPA, *Criteria for the Independence of Supervisory Authorities* (EIOPA criteria).

17 *Principles Relating to the Regulator of the Objectives and Principles of Securities Regulation* para 2 p 4.

18 Key issues related to Independence of the *Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation* para 4 p 26.

19 *Objectives and Principles of Securities Regulation*. Principle A, para 8.

20 *Principles Relating to the Regulator of the Objectives and Principles of Securities Regulation* para 2 p 4.

state, too detailed criteria may have resulted in difficulties for certain NCAs, although they could well achieve the desired outcome using different means. In addition, the criteria do not intend to be exhaustive and address all individual types of situations and circumstances but to provide a clear view on the objectives to be achieved. With this approach, the NCAs can define their own implementation path for the criteria.²¹

02

Focus on some ESAs joint criteria

Some of the ESAs joint criteria exceed international standards, such as the IOSCO principles, and are particularly relevant to foster supervisory independence. This is the case for instance for the criteria that aim to foster the good functioning of the NCAs' governing body, to avoid and manage conflict of interests and to reinforce transparency. They are further discussed below.

3.1 Fostering the good functioning of the NCAs' governing body

The good functioning of the governing body within an NCA is essential to protect and foster the NCAs' supervisory independence. Indeed, the governing body must operate independently from external influences, such as industry pressure or political interference, so supervisory decisions are made objectively and without bias. For this purpose, the criteria establish a framework for the appointment process of the governing body members, their selection and ensure transparency regarding the profile of the appointed member.²²

First, the criteria require that the process for the appointment of members of the governing body be set out in legislation, be publicly available and include certain provisions. Indeed, given the key role of members of the governing body, their appointment process should not be left to discretionary practices and instead the process should be set in law. It is worth noting that the criteria refer to key aspects of the appointment process and therefore flexibility remains, outside of these key aspects, to shape the process as needed.²³

Second, to complement the framework for the appointment process of members of the governing body, the criteria also establish a framework for their selection: candidates are required to have high integrity, individual relevant qualifications, as well as specific skills, knowledge and experience. In addition, members of the governing body who are responsible for international cooperation should also demonstrate a proficient level of English. Indeed, the full understanding of the framework and discussions by members of the governing body constitute the first line to support the independence of the NCAs' decision making.

²¹ Introduction of the *ESAs Joint Criteria* (JC 2023 17 -25 October 2023).

²² Absence of undue influence and section; The functioning of the governing body of supervisory authorities of the *ESAs Joint Criteria* (JC 2023 17 -25 October 2023) ss 2-1, 2-7.

²³ Appointment of members of the governing body of the *ESAs Joint Criteria* (JC 2023 17 -25 October 2023) s 3.1.

Finally, as not all NCAs use a public call for candidates for the selection of members of the governing body, the profile of the appointed candidate should be publicly disclosed. This is to ensure transparency, incentivise the selection of a candidate with an appropriate profile and ultimately preserve the independence of the NCA.²⁴

3.2 Avoiding and managing conflict of interests

Conflict of interest is a key topic to foster supervisory independence. Indeed, promoting and fostering supervisory independence involve the avoidance of conflicts of interest and, when not possible, their adequate management. For this reason, the provisions of the criteria related to conflict of interests apply to both members of the governing body and staff members.²⁵

The concept of conflict of interest used in the joint ESAs criteria includes real, potential and perceived conflicts of interest. Indeed, the mere perception that there are conflicts of interest may put at risk and seriously damage the reputation and credibility of an NCA, therefore putting at risk the proper functioning of the financial market.²⁶ This could be the case for example, when the spouse or a parent of an NCA's chair would obtain a senior position in a supervised firm. The IOSCO principles do not explicitly refer to perceived conflict of interests. However, the OECD considers that "undue influence, whether real or perceived, can undermine a regulator's ability to behave in this way, impinge on its independence, and ultimately, on its performance."²⁷ In the same direction, the IAIS Core Principles stress that "the supervisor should have policies and processes or a code of conduct to avoid or manage real, potential or perceived conflicts of interests"²⁸ and the Ethics Framework of the European Central Bank (ECB) also refers to "situations that ... may be perceived to give rise to conflicts of interests."²⁹ It was therefore important for the joint ESAs criteria to also cover perceived conflicts of interest.

However, although the joint ESAs criteria retain a broad concept of conflict of interests, the cautious application of proportionality is equally important. Indeed, while the objective to foster supervisory independence is of paramount importance, each specific situation needs to be considered to apply the criteria in a balanced way. For instance, a staff member with no or very limited access to supervisory information is less likely to face a situation of conflict of interest than a member of the governing body with large access to sensitive supervisory information.

24 Selection criteria of the ESAs, *Joint Criteria* (JC 2023 17 -25 October 2023) s 3.2.

25 Conflicts of interest of the ESAs, *Joint Criteria* (JC 2023 17 -25 October 2023) s 3.4

26 *The Ethics framework of the ECB.*

27 OECD, *Practical Guidance Against Undue Influence* "Creating a culture of independence" 2.

28 *Insurance Core Principles and Common Framework for the supervision of internationally active insurance groups* Principle 2.1.6.

29 *The Ethics Framework of the ECB* (2015/C 204/04) art 3.

In that context, to prevent conflicts of interest, the joint ESAs criteria ban the holding of “financial interests” in entities supervised by the NCA for staff and members of the governing body.³⁰ Indeed, such holdings could result in a biased behaviour impacting supervision or enforcement. For instance, in the review of a prospectus or in an investigation, a staff member may conduct supervisory activity or make decisions where a conflict could arise should they hold some financial interests in the firm issuing the prospectus or subject to investigation. The ban also extends to the holding of consultancies, directorship in these entities as well as the expectation of any future benefit or the involvement in any capacity in these entities. The ban, however, still allows the member of the governing body or of the staff to be a consumer of retail financial services such as, for instance, holding rights in a collective pension plan. In addition, the NCA could allow members of its governing body or staff to keep their financial holdings when joining the NCA, subject to certain conditions. The first condition relates to the “prior assessment” of the potential conflicts of interest by the NCA, and the second condition to the “management of any relevant conflict of interests” by the NCA.³¹ These two conditions imply that the NCA has in place a process to perform that prior assessment and a framework to require the sale of the financial interests when required.

Finally, situations where a member of the governing body or of the staff decides to leave the NCA also presents an increased risk of conflicts of interest. For instance, the staff member may wish to join a supervised firm. Specific measures should therefore apply in these situations and key tools to prevent or manage conflicts of interest include: (1) limiting access to relevant supervisory information during the notice period, and (2) setting a cooling-off period after leaving the NCA. However, the application of both tools has implications, in particular with regard to the ability for NCAs to attract junior and senior staff³². In these circumstances, using proportionality will be of paramount importance. Indeed, the limitation of access to supervisory information or the length and scope of the cooling off period will depend on the actual work done by the staff member, the level of decision-making, and the seniority.³³

30 ESAs, *Joint Criteria*, JC 2023 17 para 40.

31 ESAs, *Joint Criteria*, JC 2023 17 para 41.

32 OECD, *Revised recommendation of the Council on principles of corporate governance*, (8 June 2023, JT03521268) 10.

33 ESAs, *Joint Criteria*, JC 2023 17 para 53.

3.3 Reinforcing transparency

NCA's transparency is another key element to ensure effective governance and to maintain public trust. In this respect, the joint ESAs criteria require NCAs to limit and disclose their external delegation of supervisory activities, to make public some documents and translate them in English when possible.

Regarding the external delegation of supervisory activities³⁴, it makes perfect sense in some circumstances like for example, to consider cost and/or expertise, as is the case for instance for delegation of tasks to entities such as ESMA or other institutional bodies.³⁵ However, the delegation of some large part of supervisory activity to entities such as commercial entities may hamper the good execution of the mission granted to the NCA. External delegation could for instance result in insufficient guarantee of independence in the execution of the tasks.³⁶ Therefore, to preserve supervisory independence, it will be important to limit the use of external delegation, to clearly define, document the processes set up and ensure transparency. In this respect, it is key to note that NCAs remain responsible for any delegated supervisory task, so the performance of an effective oversight of the delegation is of paramount importance for the NCAs.

To ensure transparency when a delegation to an external entity is set up, it should be publicly disclosed. The disclosure should not entail information on all the details related to the delegation but on the principle like for example, what is delegated and to whom the delegation is granted.

Furthermore, as transparency about the supervisor's responsibilities is important to support NCAs' independence, NCAs' reports related to its objectives, priorities and performance should be publicly available.³⁷ However, given the significant number of languages used in the EU, publishing reports in local language is not sufficient to ensure transparency. This is why the criteria require that supervisory requirements and information about the supervisor's responsibility be available in English. Indeed, using a common language supports broad access to the documents and allows comparability across NCAs. However, the translation of a large number of documents represents a burden and a cost. So, to balance the need for transparency and the burden/costs of translation, the criteria use a proportionate approach. When translation is not possible for some defined documents,³⁸ it can be replaced by a short description in English. This would apply for instance for public consultations, for the analysis of the responses.

34 [ESAs, Joint Criteria](#), (JC 2023 17) s 2.4..

35 [Regulation \(EU\) No 1095/2010 of the European Parliament and of the Council of 24 November 2010](#), art 28.

36 [ESMA, Report on the independence of National Competent Authorities](#) (ESMA42-110-3265 18 October 2021) para 62.

37 [ESAs, Joint Criteria](#) s 5.2.

38 [ESAs, Joint Criteria](#) paras 76-77.

03

Conclusion

Following the 2021 stock-take on supervisory independence, the publication of the joint ESAs criteria on 25 October 2023 is an important step to further foster supervisory independence. Indeed, NCAs can use the guidance provided by the criteria to further analyse their situation and identify where progress could be made. They can also use the criteria externally to support their proposals, for instance to Ministries, to reinforce their supervisory independence.

Furthermore, the revised CRD³⁹ contains specific provisions related to the independence of supervisory authorities and requires EBA to issue guidelines “...on the prevention of conflicts of interest in, and on the independence of, competent authorities, taking into account international best practices.”⁴⁰

As a next step, the ESAs could perform an assessment of NCAs against the joint ESAs criteria. This would help identifying and sharing good practices and fostering supervisory independence, as well as potential weaknesses still to be addressed. This exercise, also encouraged by the European Commission,⁴¹ would require both an appropriate format and timeframe. The assessment combined with the EBA guidelines could be important additional steps to build on the joint ESAs criteria and further foster supervisory independence.

39 Directive (EU) 2024/1619 of the European Parliament and of the Council of 31 May 2024.

40 Directive (EU) 2024/1619 of the European Parliament and of the Council of 31 May 2024, arts 1(2)-(4).

41 European Commission, *Report from the Commission to the European Parliament and the Council on the operation of the ESAs*, 11.

