EUROPEAN PARLIAMENT

COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS

- PUBLIC CONSULTATION -

Questionnaire for the public consultation on enhancing the coherence of EU financial services legislation

The European Parliament's Economic and Monetary Affairs Committee is launching a public consultation on ways to further enhance the coherence of EU financial services legislation. Given the transition to a single rule book in financial services across the EU and the EU legislator's willingness to have "all financial markets, products and actors covered by regulation" it is increasingly important to ensure that legislation fits together seamlessly. The consultation will feed into a programme of reflection to determine future priorities for the remainder of this mandate and to inform the priorities for the incoming Parliament in 2014. All interested stakeholders, including academics and informed individuals, are invited to complete the Committee's questionnaire by 12 noon CET **on Friday 14 June and send it by e-mail to: econ-secretariat@europarl.europa.eu.** All responses to the questionnaire will be published, so please do not send any confidential material with your response. Please make sure you indicate the identity of the contributor. Anonymous contributions will not be taken into account.

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QUESTIONS

General comment

The questions in the first section of this questionnaire (questions 1 to 5) could be interpreted as being based on the assumption that regulation is always “bad” for the financial industry and that the main interest of financial industry lobby is to limit regulation as much as possible.

As a general comment to this section, we believe that more regulation and business efficiency are actually not always opposites. Recent research at New York University[1] has shown that, specifically in

financial services, the industry performs better in a regulated framework that provides fair competition, a level playing field, a stable economic environment and legal and regulatory certainty. In addition, we would argue that a fair regulatory environment without loopholes provides the right incentives for corporations that use their competitive advantages to invest in long-term sustainable economic activity rather than in temporary regulatory arbitrage.

[1] Philippon, Thomas, "*Has the Finance Industry Become Less Efficient?*", New York University, November, 2011, available at http://pages.stern.nyu.edu/~tphilipp/papers/Finance_Efficiency.pdf - Figure 12 shows that unit cost of financial intermediation has gone up since the 1970s despite IT innovation and increased competition which should have normally reduced the cost of financial services. This study is currently being 'replicated' based on EU finance industry figures.

See also Philippon, Thomas and Reshef, Ariell, "*Wages and Human Capital in the U.S Financial Industry: 1909-2006*", National Bureau of Economic Research, Cambridge MA, January 2009.

1. Are there specific areas of EU financial services legislation which contain overlapping requirements? If so, please provide references to the relevant legislation and explain the nature of the overlap, who is affected and the impact.

In line with the comment above, we stress that in general overlapping requirements do not always mean contradictory requirements, and that while overlaps are to be avoided wherever possible, such overlaps are not by definition useless.

We would argue that there actually underlapping requirements and pieces of regulation. The current legislative framework for financial services in Europe is a large patchwork. Please refer to our answer to Q2 below for suggestions on where the most urgent regulatory gaps exist.

2. Are there specific areas of EU financial services legislation in which activities/products/services which have an equivalent use or effect but a different form are regulated differently or not regulated at all? If so, please provide references to the relevant legislation and explain the nature of the difference, who is affected and the impact.

In the past two years, we have come across inconsistencies in nearly every legislative dossier that we have worked on. This is not a criticism of the work done by legislators but simply a consequence of the step-by-step approach of post-crisis financial legislation, focusing on one sectorial directive at a time (see answer to Q10 for suggested remedies). Below are some examples.

Retail financial services

In the field of retail financial services, UCITS has undoubtedly led to massive changes in the way that retail funds are manufactured and distributed across Europe. While never meant as a quality label, it has become the de facto standard for the retail market[2]. As a consequence, we must reassess what the value of allowing products outside the UCITS framework is, a debate that is overlapping with the current negotiations on the scope of the PRIPs/KID proposal. As PRIPs would apply to both UCITS and non-UCITS products and may be extended from distribution rules to include manufacturing rules, there will by definition be a distortion of the level playing field between different retail financial products. To avoid adding a second dimension to the equation (UCITS/non-UCITS and PRIPs/non-PRIPs) and creating four regulatory regimes for financial products across asset classes, it would be desirable to extend the scope of PRIPs to include all investment products sold to retail consumers. If this is not done during the current PRIPs proposal, it should be considered at a later stage.

Similarly, the forthcoming Regulation of Money Market Funds restricts securities lending and repurchase agreements (repo) from a consumer protection perspective. However, these practises

continue to be allowed in other (UCITS) retail financial products (e.g. ETFs), leading to inconsistencies in the consumer protection framework that can only be addressed effectively with horizontal legislation.

Prudential supervision

Capital requirements are now widely used across the financial industry to provide a backstop to avoid potential losses due to systemic failure. Although many parts of the financial sector have seen the introduction of capital requirements as part of being brought under the umbrella of European financial regulation, the patchwork still not covers the entire financial industry, including credit intermediation and transformation outside of the traditional banking system ("shadow banking"). Shadow banking allows activities such as securitization that are regulated in the "normal" banking system (e.g. through CRD retention requirements) to continue in the unregulated system.

We urge the Parliament and the Commission to consider the completion of a prudential supervision framework as a priority for the next mandate. This should include completion of the Trading Book Review in order to reduce arbitrage possibilities on capital requirements that continue to exist, even when CRD IV is implemented. It may also include the introduction of a framework for capital requirements for occupational pension funds.

Market infrastructures

The European choice to implement the G20 Pittsburgh commitments through multiple separate legal instruments (including EMIR and MiFIR/MiFID II) rather than one large piece of legislation such as the U.S. Dodd-Frank Act, has led to the situation where one piece of legislation (EMIR) is already being implemented while negotiations on another one (MiFID II) drag on. This limits the room for manoeuvre in the MiFID II negotiations and may lead to a suboptimal outcome. As an example, the generous thresholds for central clearing requirements and the exemption for corporate treasury activity granted under EMIR (and to a certain extent under REMIT's OTC intra-group exemption), limit the ability within MiFID II to reduce the amount of OTC derivative transactions as these transactions are not subject to the EMIR central clearing provisions and therefore not subject to the MiFID II trading obligation and to potential MiFID II position limits.

[2] According to the Commission's Staff Working Paper on PRIPs, UCITS products represented 58% of the market for packaged retail investment products in 2009.

3. Do you consider that the way EU financial services legislation has been transposed or implemented has given rise to overlaps or incoherence? If so, please explain the issue and where it has arisen, giving specific examples of EU financial services legislation where applicable.

The post-financial crisis legislative work heavily relied on maximum harmonization to avoid the national interpretations and gold-plating (topping-up of European requirements) common a decade ago. This improves coherence and seems to be successful, as we have actually heard national parliaments[3] complain in the context of CRD IV implementation that their freedom to interpret rules and add additional requirements is strictly limited.

There is an overlap in tasks between the national supervisory authorities and the ESAs, through some Articles 9 and 18 of the ESA Regulations that allow the ESAs to directly intervene and override national decisions in cases of significant threat to cross-border financial stability (Article 18) or retail consumers (Article 9). Due to these provisions, the ESAs have been made a 'referee' for decisions made by national supervisors in many pieces of legislation (e.g. short selling). Although these powers have to

our knowledge never been used, it complicated legislative negotiations at the time.

[3] e,g, as expressed by members of the German Bundestag during the hearing on the German CRD IV implementation law, 7 May 2013.

4. How has the sequence in which EU financial services legislation has been developed impacted your organisation? Please identify the relevant legislation and, where applicable, specific provisions and explain the nature of the impact.

The nature of the financial crisis unfolding step by step leads to the incremental discovery of gaps in legislation, e.g. in the field of short selling or more recently concerning benchmarks. The growth of shadow banking is another development that will continue to fuel the need for regulatory intervention. The *order* of such legislation is not a regulatory choice, but a consequence of developing insight into the failures of the financial system. In parallel to addressing these failures, the European institutions should consider developing a coherent and global vision of the future financial services framework and determine the steps needed to implement it (see answer to question 6d).

The relatively rapid follow-up of legislative initiatives in certain areas (e.g. credit rating agencies 1/2/3, MiFID I and II and the forthcoming review of AIFM) is an unfortunate but unavoidable consequence of the need to continuously evaluate the legislative framework in parts of the financial sector that were previously unregulated.

5. Are there areas of EU financial services where the difference between forms of regulation (non-binding Code of Conduct or Recommendation to Member States vs legislative proposals) has affected your activities?

n/a

6. How do you think the coherence of EU financial services legislation could be further improved?

Please comment in particular on the extent to which the following would help to improve the coherence of future EU financial services legislation (please give examples to support your answer where possible):

a) a framework for legislative reviews or review clauses included in initial pieces of legislation which link to the reviews of other related legislation?

The lack of a Parliamentary right to initiate legislation at the European level means that once the European Parliament (and Council) signs a law, it has no way to force a review or repeal when deemed necessary. In the past, one of the common mechanisms to deal with this issue was the use of a "sunset" clause, a measure by which legislation would automatically fade out unless it was revised in due time. This would force the European Commission to initiate a review, giving Parliament the possibility to modify the legislation if it wished to do so. However, these reviews are time-consuming and may not always address the most urgent regulatory needs. In a sunset system, they must however take place since otherwise hard-fought legislation would expire, which would be hard to defend in the current regulatory context.

Under the Lisbon Treaty procedures, more flexibility is embedded in the Level 2 process, which reduces the need for Level 1 legislative reviews. From this perspective, we feel that a framework for reviews giving Parliament some sort of informal right of initiative for legislative reviews would be a better

solution than systematically programming mandatory reviews in every single piece of legislation.

As an example, a legislative review framework could have efficiently dealt with discussions on depositary liability. The rules on depositary liability were not introduced through a horizontal directive (where the scope would have been depositaries) but rather as amendments to vertical directives such as AIFM and UCITS. Incorporating evolving insight (e.g. from the Lehman Brothers winding up process) into UCITS V would mean that the rules would no longer be synchronized to those applied to AIFM depositaries.

A similar mechanism could be built for the harmonisation of sanctions or for common remuneration structure rules, which so far has been done using "copy/paste" from one vertical directive to another.

b) a unified, legally binding code of financial services law?

We support the idea but do not really see enormous added value of an overhaul at this stage. Given the regulatory workload, in our view the European Union cannot afford the "luxury" of an omnibus exercise. It would also mean that changes to the legislative framework would have to be suspended pending codification, something that is currently not feasible due to the rapid evolvement of legislation to keep up with markets.

Direct benefits may also be limited, as most legislation is in the form of a directive and these are often already merged at a national level. Many member states[4] do not implement directives in specific national laws but rather amend an existing "umbrella" financial services law to incorporate new European directives.

c) different arrangements within the EU institutions for the handling of legislative proposals (please specify)?

The desire to reach agreement in first reading has in many cases led to a slower result than would have been possible if the "traditional" procedure of multiple readings without informal trialogues had been followed. Informal trialogues also lead to reduced democratic scrutiny (see answer to question 9).

Financial markets develop so rapidly that it is often beneficial to apply new insights to an existing legislative proposal. As an example from the MiFID II negotiations, evolving thinking on high frequency trading is pointing towards a compromise involving technical measures such as order-to-trade restrictions and a minimum tick size. The push for such changes has to come from the Parliament (or Council), as the Commission cannot (politically) introduce new suggestions at this stage.

If single reading decision-making remains the de facto standard for the time being, but single readings can nevertheless easily take up to two years, we should consider mechanisms to "update" legislative proposals. The Treaty already provides some possibilities, as demonstrated by the Commission's benchmark-related update to the Market Abuse Directive Review, following the LIBOR scandal.

d) other suggestions?

In general, financial services legislation in the post-crisis era could be described as "fire fighting", lacking a general vision of direction.

In addition to dealing with day-to-day problems, the Commission could build on previous experience such as the Financial Services Action Plan and more recent targeted initiatives such as the Green Paper

on Long-Term Financing, to provide a vision on a medium-term financial system serving the interests of the European economy. After properly consulting on that vision, the Commission could then take the necessary legislative steps to move towards its implementation.

[4] e.g. through one single umbrella law (France, UK, Netherlands) or through a limited number of specific laws (Germany)

7. What practical steps could be taken to better ensure coherence between delegated acts and technical standards and the underlying "Level 1" text?

In the key controversial cases over the past years (short selling, AIFM and EMIR), political decisions have been labelled as "technical" and delegated to Level 2 whereas they should have been dealt with under Level 1. This is inherent to the Level 1 decision-making process, which is under time pressure and where different political ambitions must be brought together. Unfortunately, the political conflict comes back once the Level 2 decisions are being taken or have to be ratified.

One example is the inter-institutional agreement on the short selling regulation, which allowed some negotiators to claim it would end "speculation against member states" whereas others suggested business as usual would continue as most financial industry participants would not be restricted by the new regulation. Both sides could claim victory but the definition of "naked CDS" was left to ESMA, as it had to interpret "high correlation" and decide what percentage of correlation would be required to qualify as a hedge (rather than a speculative position). This figure was presented as a technical decision but is in fact a political one, as an extremely generous definition would do nothing to restrict speculation, whereas a very tight definition would completely lock up the market.

Similarly, in the context of the EMIR technical standards there was disagreement as to whether the Level 1 process had intended for (derivative) positions to be calculated on a gross or netted basis, for the purposes of calculating applicability of the central clearing threshold. In our view, allowing netted positions would have exempted a significant number of market participants from the central clearing requirement, beyond what was agreed at Level 1. If the Level 1 process produces this kind of impreciseness, it should be no surprise that there is always someone who will disagree with whatever decision ESMA (and the Commission) come up with[5].

On the other hand, Level 2 possibilities are also sometimes underused. This can be illustrated with the negotiations on the Key Information Document for Packaged Retail Investment Products (PRIPs). The exact wording of the headings in a Key Information Document is subject to dozens of amendments, but in our view could have been delegated to the ESAs in line with existing best practise and harmonisation work, with whom the ESAs have had experience from the days of the Level 3 Committees (CESR, CEBS, and CEIOPS). It would also allow for these texts to be subject to more consumer testing without delaying the legislative process.

To achieve a better "division of tasks" between Level 1 and Level 2, we therefore recommend that:
- The Level 1 text should be as clear as possible and particularly avoid woolly language ("very high correlation") to mask disagreement;
- Political decisions should not be dressed up as technical interpretations. Such decisions should not be left to a Commission Delegated Act and especially not to Level 2 technical standards. Political decisions should be subject to the public scrutiny of the co-legislators, and should not be taken in a technical process that suffers from unbalanced interest representation (see answer to question 8).
- Whenever decisions are delegated, the ESAs and the Commission should have proper guidance to understand the political compromise at Level 1, e.g. through Recitals or even a specific separate declaration;
- Wherever possible, typical Level 2 work should be done at Level 2 and not at Level 1.

Some policy makers[6] have suggested inviting participants of the ESAs into trialogue negotiations, to stop negotiators from delegating political decisions to Level 2. Although we would support a trial to see if this would prevent the lack of Level 1 "guidance" that plagues the interpretations at Level 2, we warn again that it is the "wooliness" of Level 1 language that actually often makes political compromises possible.

[5] Steven Maijoor, Chair of ESMA, commented on 27 March 2013 in a speech that *"technical standards are by their nature of a purely technical nature. Scrutiny of our standards should not result in reopening the difficult political decisions that were taken when EMIR was adopted by the European Parliament and the Council."*
[6] e.g. MEP Sven Giegold at the Commission Hearing on the review of the European Supervisory Agencies, 24 May 2013

8. Which area or specific change would you identify as the highest priority for the 2014-2019 mandate in terms of improving the coherence of EU legislation?

In our view, one of the major areas that suffer from regulatory incoherence is the regulation of (OTC) derivatives. REMIT, EMIR and MiFID II are inconsistent in terms of scope, definitions and exemptions (for non-financial companies and for treasury financing, etc.). In light of the G20 commitments, we would suggest the Parliament to revise this framework in due time, if possible further restricting the ability to transact on an over-the-counter basis, as agreed at G20 level in 2009 (see answer to question 2 for more detail).

To increase coherence in general, we would encourage the European institutions to strongly focus on legislative initiatives that harmonize existing national rules and undo in particular initiatives by member states to introduce national rules solely for the purpose of influencing European debates (see our response to question 10 on vertical and horizontal legislation).

Examples of national laws mainly or solely intended to influence the European legislative outcome:
- The Financial Transaction Tax enhanced cooperation proposal is technically speaking a harmonizing measure rather than adding European regulatory burden, as it replaces several (potential) national tax regimes, including the recently introduced French FTT;
- The debate on bank structure reform at European level is burdened by the fragmentation and uneven playing field created by the German and French bank (non-)reforms[7];
- The German law on high frequency trading pre-empts European discussions in the context of MiFID II[8].

[7] Erkki Liikanen in a speech on 23 May 2013 in London said that "*even though some countries are moving earlier now, I hope they take measures which can be compatible in the medium-to-long term with the European solution*".
[8] "*Der deutsche Entwurf (...) nimmt die in Europa geplante Regulierung des Hochfrequenzhandels auf nationaler Ebene vorweg und ergänzt sie*", press release from the German Finance Ministry, 26 September 2012

9. Do you consider that the EU legislative process allows the active participation of all stakeholders in relation to financial services legislation? What, if any, suggestions do you have for how stakeholder participation could be enhanced?

Public financing of expert centres such as ours is a crucial mechanism to restore the balance between legitimate industry interest representation and a civil society counterweight. Our membership is diverse, but we cannot be a full substitute for broad engagement with all diverse parties in civil society. We therefore encourage the Parliament to continue an active dialogue with non-industry stakeholders, as an institution and as individual MEPs.

Despite good efforts to improve participation of a wider group of stakeholders in the creation of

financial services legislation, external developments have made it more difficult for non-industry stakeholders to influence legislation. In general, non-industry stakeholders have established access to Level 1 negotiations, but find it harder to influence Level 2 developments or "Level 0" international agreements preceding European legislation.

We have identified four major developments that hamper active participation of non-industry stakeholders in the legislative process: complexity and workload of financial services regulation; the growing number of legislative proposals based on international agreements, opacity of the Level 1 decision-making process and continued unbalances in stakeholder groups.

Complexity and workload

The legislative process has become increasingly complex, particularly in the area of financial services where key decisions are made outside of the three European institutions. Due to resource constraints, it is often impossible for non-industry stakeholders to monitor developments in the supervisory agencies (including the development of technical standards) and in international bodies such as BCBS and IOSCO, let alone attempt to influence them. This adds to the increased workload as a consequence of the financial crisis.

International debates predefine the EU process

Secondly, many European financial services debates are pre-empted at an international level ("Level 0"), limiting the Commission's freedom when drafting legislative proposals. As an example, many of the fundamental debates on capital requirements were held in the context of Basel Committee meetings, well before the European debate on CRD IV. Non-industry stakeholders are unable to effectively make their voice heard at this level (e.g. in the current Trading Book Review discussions), putting them at a disadvantage even before the European negotiations start.

The European Parliament should be concerned about the lack of effective democratic scrutiny of discussions made at international level. The powers of the Parliament are restricted as the European Union as a whole has committed itself to the implementation of certain international agreements, and the institutions have to work in a framework that has been previously agreed at a global level. The negotiators developing these frameworks are generally national civil servants who are accountable to their Ministers who are formally accountable to national parliaments. However in practise these scrutiny chains are too weak to be effective and we have not seen European Finance Ministers being scrutinized by their national parliaments over the work of their staff in the Basel Committee.

If non-industry stakeholders are not able to properly provide counterweight to industry pressure at international level, and the European Parliament or national parliaments cannot or do not directly scrutinize these negotiations either, serious democratic concerns are at stake.

Lack of transparency at Level 1

The European Parliament has made great efforts to make its decision-making more transparent, enabling all stakeholders to better monitor legislative developments.

However, at a micro level, industry stakeholders still benefit from superior resources to closely follow legislative negotiations. Most NGOs do not have the capacity to do so and provide an effective counterweight to day-to-day industry pressure. While we respect the need for Parliament and Council not to have every single internal meeting made public, we warn that the financial industry has very good insight into and influence on developments in Parliament compromise negotiations (shadow rapporteur meetings), Council Working Party meetings and Coreper meetings, and trialogues. As in our view these

meetings can never be completely secret and will always be prone to in-between lobbying, we suggest accepting this as a fact of life and giving non-industry stakeholders the tools (e.g. full transparency on meeting schedules, minutes and circulated drafts) to better understand the process.

Expert groups remain unbalanced

Finally, many expert groups remain unbalanced, despite recent reforms particularly in the Commission. The creation of specific expert groups for non-industry stakeholders is not a solution as it cuts them off from the discussions inside the industry stakeholder groups. In addition to and perhaps in response to the increased transparency of expert groups, we continue to see many "informal exchanges with stakeholders" outside of the context of formal expert groups, and despite Commission commitments to streamline exchanges with stakeholders in more formal structures. Some of these informal exchanges are split up by target audience (e.g. one hearing for industry, one for NGOs, one for academics), which makes it hard for non-industry stakeholders to understand and counterbalance the arguments advanced by industry stakeholders in another meeting.

Non-industry stakeholder participants in expert groups also report that funding levels are inadequate to properly act as a counterweight to industry stakeholders. As an example, some ESA stakeholder groups reimburse travel expenses to non-industry stakeholders only. However this does not compensate for the fact that industry stakeholders come to meetings much better prepared as they are able to use internal resources to prepare their position or even contract external research, even though they are formally not supposed to do so and are expected to sit on the stakeholder groups as private individuals. An alternative to direct funding of non-industry stakeholders could be additional in kind assistance from the relevant ESA secretariat.

10. Do you consider that EU legislators give the same degree of consideration to all business models in the EU financial sector? Please explain your answer and state any suggestions you have for ensuring appropriate consideration of different business models in the development of EU financial services legislation.

We welcome increased diversity in financial services. However, while the promotion of alternative business models is important, we would warn against labelling the consideration of alternative business models as the solution to improved diversity. The problem is not the business model, but the behaviour of individual firms, irrespective of their business model. A pension fund that engages in speculative derivative transactions has the same impact on the market as an individual investor or an investment bank doing a similar transaction.

The question suggests that firms using traditional business models are perhaps overrepresented in terms of lobbying. This is unavoidable as established large institutions simply have more resources to dedicate to lobbying. Trade associations that try to balance the interest of all their members still have to accept that dominant members engage in lobby campaigns of their own, increasing the exposure of policy makers to the dominant traditional firms.

We note that often providers of alternative business models are non-traditional players that do not fit into the existing regulatory framework, which by definition is always behind on market developments. A typical example is the transition of retail banking services provided by traditional banks to alternative payment service providers using Internet-based services within the e-money framework.

The financial crisis has led to a great number of 'vertical directives' targeting a specific type of financial services subsector, e.g. short sellers, alternative investment funds, credit rating agencies and money market funds. By definition, this creates arbitrage possibilities as actors try to provide similar services

outside of the regulated framework. A solution here would be to move back to more horizontal legislation, including from the perspective of the user of financial services and of society as a whole. In our view, this would help to rebalance the "lobbying level playing field".

Note on answering the questions

Please clarify in your answers whether your example relates to financial services legislation in force, or to proposals still under consideration. For example, if you refer to MiFID as an example, please specify whether your point relates to Directive 2004/39/EC ("MiFID 1") and accompanying implementing measures, or to the MiFID 2 negotiations based on Commission proposals COM (2011) 652 and 656.