Ref: EBF_025993

Brussels, 17 March 2017

Commissioner Valdis Dombrovskis,
Commissioner for Financial Stability, Financial Services and Capital Markets Union,
European Commission

SUBJECT: EBF Paper on the Capital Markets Union Mid-Term Review

Dear Vice-President Dombrovskis,

The European Banking Federation (EBF) appreciates the opportunity to comment on the progress of the Commission's Capital Markets Union (CMU) Action Plan at its mid-term review. We commend the Commission for undertaking this initiative to build capacity in capital markets in all European Member States and to remove obstacles to the cross-border flow of capital.

In this paper, we examine the progress to date and remaining challenges in terms of (i) Regulation, (ii) Supervision and (iii) Technology.

In particular, the EBF recommends that the Commission takes the following actions to contribute to the success of the CMU and to achieve successful implementation of its action plan going forward:

- Provide strong leadership and technical expertise during the STS securitisation trilogue in order to create a solution that will revive securitisation markets;

- Revise the proposal on insolvency proceedings to consider a balanced approach taking the interests of both debtors and creditors into account that would contribute to solving the issue of non-performing loans;

- Play a greater leadership role in the furthering of financial education in Europe as a way to empower entrepreneurs, consumers and investors. This enables individuals and companies to improve their understanding of financial opportunities and funding options available to them.

The need for CMU:

European banks fully endorse the intent and objectives behind this project and are committed to working closely with the Commission on the policy initiatives set out within the CMU Action Plan. Banks play a pivotal role in helping their clients access capital markets as intermediaries, for example by helping corporates and businesses manage risks, tap capital markets to raise funding and finance and provide advisory service; banks also help investors invest in single or diversified instruments that match their specific needs. As intermediaries and users of capital markets themselves, banks have a strong interest in well-functioning and customer focused capital markets.

The EBF and its members consider that Europe needs efficient and dynamic capital markets to complement a strong and stable banking sector. Achieving this goal will contribute to the provision of diversified funding opportunities and the enablement of economic growth. In this context, it is important to note that there are unique benefits to capital market financing (e.g. the collective wisdom of investors, 'the market', channelling savings towards investments) as there are to bank financing (e.g. the close and direct link to the client, the long-term relationship based on a comprehensive understanding of the client's needs, the ability to tailor solutions to a client's needs and a better ability to price risks). Therefore, as Europe strives to remove the obstacles to capital market financing, the unique benefits of bank lending should not be set aside. Our goal should be to seek a more balanced system that provides businesses, consumers and investors greater choice without privileging or undermining any of these two main types of financing.

We are broadly positive about the potential of the CMU and we are heading into a period when open and global facing European capital markets are required more than ever. As such, we concur that it would be useful to consider certain fundamental questions about the kind of capital markets Europe needs and how they can be brought about. Some of the important questions include, for example, the geographic and political differences in Europe in terms of capital markets infrastructure, the impact of technology, regulation, and macroeconomic factors in the coming years on capital market demand and supply, and how growing companies can be better served as they move along the funding 'escalator'. The EBF and its members are ready to work with the Commission on these issues not only in the context of the CMU.

Taking stock of progress to date:

Europe’s capital markets are still behind those of its global peers and more thought is required on how to ensure capital markets become more dynamic and customer-focused, particularly in the current geopolitical environment. During the course of 2016, de-listings surpassed new listings with 11,537 companies listed on European equity exchanges falling to 11,295. Equity underwriting fell sharply too, by 39% over 2015.[1] Numerous studies have shown the difficulties shown by European IPO markets.[2] More work needs to be done.

The Commission has made progress in some aspects of its CMU Action Plan. For example the Call for Evidence enabled the Commission and industry participants to work together to identify and analyse financial services regulation that led to unintended consequences and burdensome overlaps. We now look to the Commission for leadership to successfully take account of the feedback in a constructive way, to ensure that there are not unnecessary layers of existing and new regulation hindering the development of European capital markets and economic growth.

Below we provide our views on the remaining challenges for (i) Regulation, (ii) Supervision and (iii) Technology.

(i) Regulation

One of the initial legislative proposals launched by the Commission that we consider particularly valuable is the **Simple Transparent and Standardised Securitisation package**. This package was proposed to enable the revitalisation of European securitisation markets by unlocking between €100-150bn of potential capital. This figure contrasts with a much lower level of issuance, which has significantly declined in Europe

[1] AFME Equity Primary Markets and Trading Report European market data update Q4 2016: [Link]
[2] FESE: A Blueprint for European Capital Markets, October 2014: [Link]

from £380bn in 2010 to under £200bn in 2016.[3] However we remain concerned about the way in which this file has developed.

Moreover, there are a number of proposals under consideration at trilogue stage which have not been appropriately evaluated. If left as drafted, it would risk restricting the securitisation market rather than provide a sound basis for its revival (please see the points outlined in our letter of 17 January 2017). There remain unanswered issues around capital charges for STS instruments, risk-retention, burdensome and unclear transparency administrative and overly penal sanction requirements. Furthermore, it is important that the final draft should not exclude third countries from the STS label. Europe's securitisation markets should not be shut off from global finance.

We ask the Commission to provide strong leadership and technical expertise in order to steer this proposal towards an optimal solution during trilogue discussions if the European securitisation market is to be successfully revived.

The EBF also supports the objectives of the new **Prospectus Regulation**, to help improve access to finance and increase clarity for investors whilst balancing consumer protection concerns and helping lighten the regulatory burden on issuers. However, the final Level 2 legislation will need to be carefully calibrated to ensure that the new Regulation works as well as possible. We look forward to engaging with the Commission and ESMA further on this file.

Regarding an EU-wide framework for **covered bonds**, the Commission is currently considering its next steps. Any initiative taken by the Commission should take into account the high quality covered bond frameworks already in place at national level.

While the EBF generally supports the proposal to revise **insolvency** proceedings, we would ask the Commission to consider the economic impact of the proposed regime on secured creditors and their ability to lend back into the economy and consider a balanced approach between the interests of both debtors and creditors. The proposal as it currently stands promotes one-dimensional, pro-borrower characteristics, is unlikely to contribute to a solution to the issue of Non-Performing Loans (NPLs) and risks creating an acute moral hazard. This could lead to reduced recovery rates for creditors and reduce their ability to relend money back into the economy.

We very much welcome that this mid-term review mentions the concept of **sustainable growth**. We believe this concept should be linked to the concept of inclusive growth and financial inclusion. The European project needs support and to this end all European citizens must feel that they can reach the benefits of this project independently of the country they live.

In the context of the CMU Mid-Term Review, the EBF encourages the European Commission and other EU institutions to take on a greater leadership role in the **furthering of financial education** in Europe as a way to empower consumers, investors and entrepreneurs, thereby contributing to sustainable growth in Europe. Whilst acknowledging the importance of consumers and investor protection, access to financial products and services, as well as the regulation of financial institutions, the EBF is undeniably convinced that financial literacy is a crucial component in enabling consumers, investors and entrepreneurs to make informed choices. Financial education unquestionably provides individuals and SMEs with insights on how to manage their finances in order to improve their financial position, and importantly, how to avoid unnecessary risks, excessive debt and potential financial exclusion. What is more, it enables individuals to improve their understanding of the financial opportunities that the products available can offer.

[3] AFME Securitisation Data Report, Q2 2016: [Link]

While financial education is needed in all areas of finance, it is particularly critical to capital markets, which offer a wide range of instruments and channels of investment. The Green Paper on building a CMU recognized the importance of financial education for consumers and investors as a way to rebuild the trust of retail investors in the capital markets. With this in mind, the EBF deems it appropriate for the European institutions, especially in the context of the CMU, to consider a certain number of actions which would recognise and promote the importance of financial education at national and European levels. These actions could range, for example, from organising reflection groups, conferences, exchange of best practices, creating partnerships, and possible use of European funds to support specific financial education-oriented actions.

The EBF actively supports the initiative of **strengthening feedback provided to SMEs when their credit applications have been declined**. The EBF has been closely working with the other European banking associations as well as the organisations representative of SMEs on the preparation of what we describe as high level principles. Based on a common understanding and respect for existing effective national frameworks, the organisations involved are in the process of finalising a document that we hope can be supported by all relevant stakeholders.

(ii) <u>Supervision</u>

The EBF fully supports the introduction of greater **supervisory convergence** across the EU. This would help to foster investment and cross-border capital flows in Europe. In order to secure the benefits of deeper financial integration, one of the objectives should be to remove undue differences in regulatory practices, which hinder the implementation of consistent regulatory approaches across Europe, and promote consistent and effective application of existing rules.

An initial positive step has been the creation of a **Single Rulebook** within the CMU framework, covering the key areas of capital markets. In this context, we believe that the Single Rulebook must be achieved by close convergence of supervisory practices that are consistently and effectively enforced across all Member States and relevant in a global setting. This would facilitate enhancement of the European Single Market, help remove barriers that hamper cross-border investment within the EU and eliminate uncertainty for investing in capital markets.

Considerable efforts have been accomplished over the last years by the European Commission and the European Securities and Markets Authority to develop a single rulebook for financial markets. Beyond convergence of the rules, efforts towards convergence of supervision have been at the core of the CMU agenda. The European Commission plans to consult soon on the review of the European Supervisory Authorities (ESAs), but the CMU mid-term review should be a first opportunity to reflect on changes to ESMA’s mandate. A first priority should be the introduction in the EU regulatory framework of a **formal power to temporarily disapply directly applicable EU legal text**, in a manner similar to the non-action letters that exist in some non-EU jurisdictions. The recent operational challenges encountered in meeting the deadline of 01 March 2017 for exchanging variation margin under the European Markets Infrastructure Regulation (EMIR) provide a good example of the benefits that such an adjustment could bring. Regulators have recognised that not all firms were able to comply fully with the pending variation margin requirements. The lack of clarity regarding the mechanisms that could be used to grant forbearance in the European Union created concerns about a possible interruption of trading with a significant number of counterparties, which would have prevented them from hedging positions and would have had a wider impact on market liquidity.

The only mechanism currently available to temporarily delay the application of a requirement is the adoption of a legislative initiative by the European Commission, which is a lengthy process and could not be used to address the issue mentioned above. The introduction of a no-action mechanism would allow ESMA to guarantee fair and orderly markets in the EU when there are temporary operational challenges to meet regulatory requirements. Beyond the broader review of the ESAs mandate, the upcoming review of the EMIR regulation could be the first vehicle to support this change, via for example the introduction of a mandate to temporarily suspend clearing obligations in exceptional circumstances.

(iii) Technology

In addition, the **digital transformation** of society will need to be incorporated in the way financial entities relate to their customers: from ensuring electronic access to providing more targeted financial advice through data analytics. As stated in the consultation, digitalization will also bring opportunities to develop sounder markets and increase efficiency. A thorough fitness check by the EU of the existing regulatory framework is necessary to ensure the current framework is up to date, future-proof and does not impede innovation and competitiveness in the Digital Single Market for financial services. Regulations and supervisory practices should be revisited in order to ensure that the benefit of innovations can be enjoyed at digital speed. Regulators could help by working with industry and wider stakeholders. The development of regulatory sandboxes/frameworks for experimentation reflects good practice and should be taken into account also for innovations in the field of financial markets.

In conclusion, we believe that if well implemented, the CMU project has the potential to reinvigorate Europe's capital markets and to stimulate the cross-border movement of funds. Europe's banking sector, with its pivotal financing role, remains fully committed to the CMU agenda and is keen to help build a new ecosystem for growth in Europe by cooperating with all stakeholders.