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House of Lords EU Economic and Financial Affairs Sub-Committee

Inquiry into the EU regulatory framework: Written evidence by AFME

30 September 2014

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to the **House of Lords' Inquiry into the EU regulatory framework.**

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

As requested for documents longer than six pages, a one-page summary is provided below. This is followed by our complete response which is structured according to the main themes of the Inquiry. Although we have not specifically addressed the last section (implications for the UK), our response covers the majority of issues raised in the Inquiry's individual questions.

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Summary of AFME's response to the Inquiry

The EU's far-reaching programme of financial reform has already been very effective in strengthen the resilience of the financial system. While the package of new rules will be fully phased-in over the next few years, banks have anticipated many of these requirements. For instance, core tier 1 capital, liquidity and leverage ratios have all improved significantly since the crisis. The effects of additional measures to reduce contagion effects caused by complex connections between banks and improve transparency in markets and infrastructure are also being felt. Central clearing of interest rate derivatives for instance has doubled within the space of a year. Moreover, the moral hazard problem inherent in the old system has been dealt with through improvements to bank resolvability with better preventative and planning tools as well as the innovative bail-in tool. In short, the EU financial system is safer, banks are no longer too-big-to fail and taxpayers will no longer be called upon to foot the bill of failure.

The benefits of reform are nevertheless accompanied by costs and, in AFME's view, the net cumulative cost of the reform package has not yet been fully quantified or properly understood. In particular, more work is required with respect to the transmission of costs to the real economy. For example, situations of undesirable bank deleveraging, where regulation has unintentionally created disincentives for activities that are economically and socially beneficial, must be examined more closely. With alternative sources of funding not yet being widespread in Europe, an appropriate framework will have to be put in place to ensure other financial services can fulfil their growth-enabling role. Securitisation in particular is an important real economy financing tool where further regulatory efforts are needed.

With the bulk of reform having been completed, a period of calm in the regulatory agenda is necessary to finalise the technical implementation of the reform package and consolidate benefits already obtained. AFME does not think that any further fundamental changes are necessary and we are particularly concerned with the EU's new proposals for Banking Structural Reform. These proposals are an unnecessary duplication of existing measures and, if adopted, will have significant adverse economic consequences, including a withdrawal of EU capital market capacity. In fact, rather than broadening sources of finance within the EU, these proposals may end up increasing reliance on bank funding. AFME also continues to have serious concerns on the Financial Transaction Tax, where evidence shows that its introduction will have harmful economic effects for end-users of financial markets throughout Europe.

There are also a number of areas of overlaps and inconsistency within the current framework that need to be addressed. For instance, consideration must be given as to how the macroprudential oversight functions of the SSM and the ESRB will work together. Within the EU, creating a single set of rules that is consistently applied is necessary to benefit fully from a Single Market for financial services. AFME is therefore support of a Single Rulebook but believes that this must go hand in hand with the development of an EBA Single Supervisory Handbook. Lastly, improved regulatory consistency at international level must also be a priority going forward. In this area, we believe that IOSCO is well-positioned to play a leadership role in addressing the many cross-border challenges facing global financial markets.

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AFME's Response to the Inquiry

SECTION 1: BROAD ASSESSMENT OF THE EU REGULATORY FRAMEWORK

The EU's far-reaching programme of financial reform has been effective in improving the financial system

1. The EU's unprecedented programme of financial reform has fundamentally reshaped the European financial services sector and its supervisory environment. Out of the 41 proposals put forward by the European Commission in the context of its reform agenda, no fewer than 29 have already been adopted into EU legislation, 11 are awaiting final adoption by co-legislators and only 1 is outstanding[1].

2. As a result, the European financial sector is now significantly more resilient than it was before the crisis. The implementation of the Basel 3 framework into EU legislation through the Capital Requirements Directive and Regulation (CRD4/CRR) has greatly reduced the likelihood that banks will fail. Comparing like with like, the CRD 4/CRR will require banks to hold ten times more equity capital than before the crisis[2]. The quantity and quality of capital in the system have already improved, with the largest EU banks' average core tier 1 capital ratio having doubled since 2007[3]. New liquidity and leverage ratios under the CRD4/CRR have already lead to Europe's largest institutions tripling their holdings of cash and halving their leverage compared to 2007[4]. Other measures, such as higher capital requirements for exposures to financial institutions and mandatory central clearing for OTC derivatives have been taken to reduce the level of interconnectedness of banks and prevent contagion effects. These impacts are already being felt. For instance, the amount of client transactions in interest rate derivatives cleared through the 2 largest clearing houses active in this product more than doubled from early 2013 to early 2014[5]. Groundbreaking measures to ensure that taxpayers no longer foot the bill of bank failure have been introduced under the Bank Recovery and Resolution Directive (BRRD). These include better preventative and planning tools as well as the bail-in tool which is designed to significantly reduce the moral hazard problem inherent in the previous system. In combination with additional requirements, coordinated at international level by the Financial Stability Board and that apply specifically to the most systemically important banks, the measures in place as part of the EU's comprehensive reform agenda mean that no European bank will be considered as being "too big to fail" going forward.

3. The EU's ambitious financial reform package also goes beyond this. A host of new rules to increase transparency in financial markets and infrastructures have been established under the new securities market framework (MIFiD 2/MiFIR). The EU's supervisory architecture has also been fundamentally transformed and strengthened through the creation of three new European supervisory authorities for the banking, securities and insurance sectors. These

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[1] European Commission, A new financial system for Europe, State of play: June 2014
[2] Paul Tucker, "Regulatory reform, stability and central banking", Hutchins Center on Fiscal & monetary Policy at Brookings, January 2014
[3] Increase in average core tier 1 capital ratio of EU G-SIBs from 2007 to 2013; source: SNL
[4] Source: SNL
[5] CME Group, LCH Clearnet

authorities are responsible for micro-prudential level supervision and are complemented by the European Systemic Risk Board (ESRB) which has responsibility to detect risks to the financial system as a whole (macro-prudential supervision). Lastly, a Banking Union for Eurozone countries has been created to break the negative sovereign-bank feedback loop from which several weaker European economies have suffered. Banking Union will also promote market integration by creating single supervisory and resolution mechanisms for Eurozone banks and should facilitate cross-border supervisory collaboration.

4. Taken together, these measures have greatly increased the stability, transparency and integration of European financial markets. The system has been protected as much as it can be from future shocks and, although it is impossible to know now whether unforeseen crises will be avoided, the risk of future financial crises occurring and leading to severe, prolonged economic crises has, without a doubt, been substantially and effectively reduced.

The benefits of reform are nevertheless accompanied by costs that affect the important economic role the financial system plays. These effects must be better quantified.

5. While the reform programme has already led to fundamental improvements in the financial system, and will undoubtedly give rise to further economic and societal benefits, it is essential that reform, particularly when so extensive, does not prevent the financial sector from carrying out its basic economic functions. A thorough assessment of the net cumulative impact of the changes outlined above is therefore necessary and must include in-depth, quantitative analysis of the impacts of reform on the industry's ability to support real economy participants and help the EU economy return to sustainable and sustained levels of growth.

6. The European Commission's Economic Review of the Financial Reform Agenda (ERFRA) is the first European-level attempt to provide such an assessment, and following our longstanding calls for comprehensive analysis, is a welcome step in the right direction. It provides an extensive analysis of the academic literature on benefits and costs of European financial reform, including an overview of the results of the Commission Services' own modelling to assess the cumulative net impacts of new capital requirements, bail-in and resolution tools.

7. While we are extremely supportive of this attempt, we nevertheless consider that it is partial and can only be viewed as the first in a series of ongoing assessments to ensure that the right balance is struck between the costs and benefits of the reform package. As it stands, we consider there are several areas where the ERFRA probably under-estimates the cumulative costs of reform:

   a. Firstly, while we do appreciate the difficulties of the exercise, we think that more work needs to be done to quantify the net cumulative impacts of measures that are part of the reform programme but have only been analysed in a largely qualitative manner in the ERFRA. For instance, the combined net effects of other parts of the CRD4 package, such as the liquidity and leverage rules, and MiFID 2 /MiFIR, to name but a few, need to be taken into account together with those aspects of reform already quantified in the ERFRA.

b. It will also be crucial to undertake detailed analysis of the influence of new regulation on the composition of banks' product mix and pricing and to acquire a more refined understanding and quantification of how changes in these areas are affecting the end-users of financial services.
c. In this respect, some of the conclusions drawn in relation to the transmission of costs of the reform to the real economy need to be revisited and finessed. For example, while we acknowledge that bank deleveraging in Europe can largely be seen as positive (e.g. banks have cleaned up their balance sheets and reduced holdings of excessively risky assets), it is still important to identify and factor into the analysis situations of "bad deleveraging" where regulation has unintentionally created disincentives for activities that are economically and socially desirable. For instance, long term investment funding has become much more expensive for banks to provide. Alternative funding sources are not yet prevalent in Europe, which potentially leaves an important gap that needs to be examined carefully. SMEs, the category of business facing the largest external financing constrains, may be experiencing similar funding gaps. Other real economy participants are also likely to be affected. For example, although corporates are not reported to have financing difficulties per se, the reform package still affects them, for instance via new wholesale market regulations that impact on the cost and availability of certain hedging activities linked to their financing activities. In our view, these elements have not been fully captured in the ERFRA.
d. As the ERFRA rightly points out, it is currently not possible to fully comprehend the overall impacts of adopted measures as some aspects are still in flux. In the area of resolution for instance, issues such as the impact of resolvability assessment and the cost of raising a "minimum requirement for own funds and eligible liabilities" (MREL) and gone-concern loss absorbing capacity (GLAC) still need to be factored into the quantitative impact assessment. The Commission Services' impact analysis work should therefore be repeated on a regular (yearly) basis to take into account the effects of implementation of the reforms as they are phased-in and their technical elements finalised through the level 2 legislative process. Moreover any new data or research findings that become available will need to be included and modelling assumptions adapted to ensure they remain relevant.
e. The assessment must also be widened to include measures being taken outside of the immediate context of the Commission's financial reform agenda set up in 2009 such as the implementation of a Financial Transaction Tax (FTT) in some Member States.
f. Last, but by no means least, the scope of the assessment will also need to account for the impacts of major parts of the reform programme that are as yet not finalised. We refer in particular to the Commission's proposals for imposing structural reform on some EU banks which we believe will have significant real economy consequences if they are to go ahead.

With the bulk of reform having been completed, the EU should focus on measures to support economic growth and recognise the role that financial services have to play in this.

8. AFME believes that it is crucial for Europe to consolidate the EU's emerging but fragile return to growth and that the financial services industry has an important part to play in achieving this. We consider that the following potential solutions could help unlock funding to enable investment and growth of the real economy and that regulation designed to facilitate these could be beneficial:

a. Small businesses – for the time being, banks are expected to remain the primary source of finance for small businesses (due to the size of transactions and the local nature of the commercial relationship). However, given the financial pressure banks face as a result of the CRD4 / CRR and other measures, increasing their lending capacity to the SME sector may require further support, either through increased capacity or increased risk appetite. Improving access to existing lending schemes through the consolidation and simplification of pan-European and national SME schemes would help, as would the creation of an SME risk and information database and the establishment or expansion of credit mediation services. AFME also believes that further education of SME borrowers on how to obtain both bank and non-bank finance is important. Additionally, the expansion of SME securitisation is necessary to help increase the funding and capital capacity for bank lending to SMEs and allow capital markets to channel funds to these businesses. Securitisation encourages existing originators to extend more loans to SMEs and, to the extent that it partially removes credit risk from bank balance sheets, it may also help smaller, less diversified originators to enter the SME loan market. It also increases the capacity for non-bank investors to finance to SMEs. A well functioning ABS market therefore helps SMEs diversify their funding sources and reduces their reliance on a limited number of lenders, thereby contributing to economic growth. We have recently seen strong support from the senior officials calling for revival of securitisation. For instance, the ECB has recently noted there is an urgent need to build "a financial landscape that is more diversified, more capital market-based for all segments of financial products"[6]. We provide suggestions on how the European securitisation market can be revived below.
b. Large and mid-sized corporates – rather than additional funding sources, mid-sized and large corporates require market making and hedging services. Separating trading activities out from core bank divisions would significantly increase the costs of these services and is therefore not desirable. We discuss this issue in more detail in paragraphs 11 to 14. Companies of this size would also benefit from a pan-European private placement market, similar to the US private placement market. To help achieve this, AFME is active in a pan-European cross-industry group which is seeking to develop a consistent set of guidelines and standard templates for such a market.
c. Infrastructure investment - infrastructure is of course crucial to long term growth and productivity. However, similarly to SME lending, funding infrastructure investment has become much more expensive for banks. This market must therefore be made more accessible to non-bank investors. A range of reforms should be considered, including rules to reduce political risks associated with infrastructure regulations or tariff structures and efforts to encourage greater acceptance of capital market instruments as part of an overall financing package. In this respect, further education of issuer municipalities across Europe on how to access capital markets in order to fund infrastructure projects could be useful. AFME also believes that the European Long Term Investment Fund (ELTIF) initiative of the European Commission could be a means to make infrastructure investments accessible to a wider group of investors.
d. Lending to businesses in distressed economies - funding issues in these countries may require consideration of solutions including the possible relaxation of certain European Investment Bank eligibility rating criteria for partner banks and refinement of sovereign

[6] Speech by Peter Praet, Member of the Executive Board of the ECB, Europlace Financial Forum, Paris, 9 July 2014

CDS regulations and swap contract triggers to improve investor ability to hedge the sovereign risk component of corporate financing transactions.

Securitisation is an important real economy financing tool and further regulatory efforts are needed to support its revival

In the existing European economic climate, securitisation constitutes an important tool for financing the economy and facilitating its recovery. The European Commission, as well as the ECB and BoE, have noted that "the reform agenda may have penalised higher quality and safer securitised products compared to other similar forms of financing". The regulatory treatment of securitisation therefore needs to be addressed urgently. Some progress has already been made, both at international and European levels. For example, capital charges for insurers (under Solvency II) and banks (under the Basel Committee for Banking Supervision's (BCBS) revised securitisation framework) have improved compared to original proposals. The Commission's intention to include a wider range of securitisations than just residential mortgage backed securities in the liquidity buffer of its Liquidity Coverate Ratio (LCR) is also welcome. However, a lot more needs to be done if we are to see investors effectively return to the market. Proper calibration of the BCBS's securitisation framework, Solvency II and the LCR will be crucial in achieving this. Other areas where improvements are required include the margin posting and clearing obligations for securitisation swaps under the European Market Infrastructure Regulation (EMIR). An exemption should be introduced here for securitisation swaps, as it has been for covered bonds. We also consider that development of the concept of "high quality securtisation" or "qualifying securitsation" by the ECB and BoE will be essential in reviving market and welcome the efforts they have made to consider definitional issues and the consequences of falling out (or in) of the "high quality" classification[7]. Nevertheless, for this concept to bear fruit, it is important that work being undertaken by the EBC and BoE is coordinated and reflected in other relevant workstreams such as thoseof the BCBS and European Commission.mentioned above. Lastly, while AFME is committed to transparency and considers that information on the quality and performance of the underlying assets and structure of securitisation transactions is of course vital for investors, we caution against placing an overemphasis on transparency as being a panacea when regulatory issues are hampering the rejuvenation of the market. These must be resolved as a matter of priority.

SECTION 2: INTERCONNECTIONS, OVERLAPS AND GAPS IN THE EU REGULATORY AGENDA

A period of calm in the regulatory agenda is necessary to finalise technical implementation and consolidate benefits already obtained

9. Although it has been necessary to address the flaws revealed by the crisis, the pace of change in EU financial services legislation is neither sustainable nor desirable if Europe is to fully reap the economic benefits of transformation that has already taken place. With the bulk of level 1 reform having been completed, and with a new European Parliament and Commission soon to become fully active, we think that now is the natural time to pause, reflect on the legislative

[7] More information can be found in AFME's response to the ECB and BoE Joint Discussion Paper and the AFME report High-Quality Securitisation for Europe. The market at a crossroads

programme of past years and its impact, and consider priorities for the future. We do not think that any further, fundamental changes are necessary at this stage and are pleased to see that the creation of a new post of EU Commissioner for Better Regulation seems to recognise the need for careful reflection before legislative action is taken at EU level[8].

10. In our view, before any additional major, level 1-type measures are considered, it is necessary to first complete the technical and detailed specification of the elements of reform that have already been adopted. Having now benefitted from first experiences of regulation developed under the level 2 process, AFME believes that it can be made more efficient and robust. We attach particular importance to the development of level 2 measures. This is because a single set of rules for the European financial sector is very much necessary for industry to reap the benefits of the Single Market and for the positive impacts of regulatory reform to be fully felt to the benefit of society as a whole. However, we think it is important to stress that the Single Rulebook will only be truly effective in reaching these goals if it is implemented by supervisors that share common practices when applying these same rules. These points are discussed further in paragraph 25.

EU proposals to restructure banks are an unnecessary duplication of existing measures and will have significant adverse economic consequences if adopted. They are not the way forward.

11. AFME is particularly concerned with the EU's new proposals for Banking Structural Reform (BSR). Given that the system has already undergone radical transformation and is now significantly more resilient, in our view there is no need to adopt such measures. At international level, work has already been undertaken to impose specific, stricter requirements on the largest international banks. Moreover, the new tools under the BRRD, such as resolution planning and bail-in in particular, will already enable banks to be wound down in an orderly manner and without recourse to the taxpayer. Additionally, pursuant to their resolvability assessments, authorities have strong powers to impose structural changes when necessary.

12. Moreover, the effectiveness of the BRRD is already being felt, with rating agencies having begun to remove the uplift for implicit government support that some banks benefited from in their credit ratings. For instance, in May 2014, Moody's changed the outlook to 'negative' for 82 European banks' long term debt ratings to reflect the likelihood of a reduction in state support and increased risk of senior creditors being bailed-in. Given that such changes are already taking place, there seems to be no need to introduce structural reform measures to address the so called "implicit subsidy" issue.

13. We understand that there may still be particular types of risks, for instance in trading activities, which regulators are concerned about. However, the Basel Committee's Fundamental Review of the Trading Book will address the capital allocation, transparency and supervisory control of these activities. Consequently, the implementation of this new framework for the trading book will substantially increase authorities' ability to address any capital adequacy or structural concerns that these activities may pose.

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[8] Press release, European Commission, 10 September 2014

14. Using proposals like the BSR to mitigate the risks associated with trading activities will interfere with the provision of client-facing activities such as the market making and risk transformation services that are part of banks' fundamental economic role. These types of client-facing activities are not high risk and they are necessary for banks to be able to trade and price financial instruments and their associated risks. AFME expects that adoption of the structural reform proposals would lead to a consequent withdrawal of capital market capacity that is likely to increase concentration and reduce competition as well as the availability of products. This would impact on end-users, creating issues that are particularly acute for smaller corporates trying to diversify funding sources and hedge business risks. We therefore find the Commission's proposals to be contradictory to its stated objective of broadening the sources of finance available to the European economy and building up capital markets in Europe. In fact, the BSR proposals are more likely to increase the European economy's reliance on bank funding rather than reduce it.

There are areas of overlaps and inconsistency within the regulatory framework that need to be addressed

15. In the new European supervisory system, characterised by the creation of the Single Supervisory Mechanism (SSM) within the Banking Union, the ESRB will have to frame its activity in a complex system composed of three different layers: the European Union, the Eurozone and individual Member States. In a recent report on the mission and organisation of the ESRB[9], the Commission recognises that the establishment of the SSM will have an impact on the role of the ESRB. Therefore, in order to avoid fragmentation of the European macroprudential supervisory framework, more consideration needs to be given to how the Banking Union macroprudential oversight approach relates to the ESRB and its role with non-SSM countries. Indeed, there should be greater clarity on the respective macroprudential roles and modes of cooperation of the ECB and the ESRB. The former, together with national authorities, should be clearly responsible for the implementation of macroprudential policy within the "Banking Union zone". The latter should be responsible for monitoring macroprudential risks across the EU as a whole, developing strong analysis and making act-or-explain recommendations to national or regional authorities. In this respect, the ECB should be in the same position as the EU-28 national supervisory authorities.

16. We also think it is important to point out that evidence[10] continues to show that a Financial Transaction Tax will have serious harmful economic effects for end-users of financial markets throughout Europe. Moreover, it is an inefficient way to raise public funds and we are also concerned about its wide scope as FTT would also apply to non-EU entities.

Improved international consistency is necessary and must be a priority going forward

17. The wider context of regulatory inconsistency at a global (and not just EU) level cannot be overlooked. In a 4 April 2014 letter to the G20, Mark Carney, Chairman of the Financial Stability Board, highlighted the need for enhanced cooperation, outcomes-based approaches to resolving cross-border issues and the building of trust between regulators. Efforts must be

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[9] COM(2014)508 Report from the Commission to the European Parliament and the Council on the mission and organisation of the European Systemic risk Board (ESRB)

[10] See for instance "What would be the economic impact of the EU proposed financial transaction tax", Oxera, June 2012 and "The Impact of the EU-11 Financial Transaction Tax on End-Users", Oliver Wyman, 2013

made to address these issues on a global scale, in order to reduce transaction costs, foster competitive markets and facilitate cross-border trading and investment - especially for corporate end-users. It is our view that IOSCO has the unique regulatory knowledge and experience to develop a framework that enables coordinated approaches to cross-border policy making and regulation.

18. We believe that IOSCO is well-situated to take a larger leadership role in addressing the many cross-border challenges facing global markets today. They can serve as a global "clearing house" for the identification of key goals, issues and possible conflict areas arising in cross-border political and regulatory spaces. This would open the lines of communication between jurisdictions, encouraging trust, coordination and transparency.

19. In particular, we view IOSCO's establishment of a Task Force on Cross-Border Regulation as a positive step forward in dealing with the emerging multiplicity of jurisdictional regimes. The Task Force will help IOSCO to take the lead in improving the cross-border challenges facing markets. Their specific role could include facilitating international dialogue between policymakers and legislative/regulatory authorities at the initiation of policy development, encouraging international coordination amongst regulators in establishing reasonable and agreed implementation timetables for new rules and developing cooperation/consultation mechanisms for identifying areas of conflict and bringing together regulators once these differences emerge. Our view is that these principles and mechanisms would assist in fostering a more consistent and coordinated regulatory framework.

20. We consider that a good example of international cooperation has been in the field of financial benchmark regulation where the FSB played an important role in coordinating the work of national financial authorities and standard setting bodies on benchmark reform. Reform is needed and should be focused on sound practices, harmonised internationally, and commensurate with the significance of the benchmark in the marketplace. At the European level, we think that the Commission's proposal for a Regulation in this field could better embody the concept of proportionality embedded in the IOSCO Principles developed at international level in such a way that its provisions are commensurate with the risks posed by a benchmark to the financial system and with the importance of a benchmark to market participants, investors and consumers. For example, we believe that there are implementation aspects such as the equivalence regime approach for non-EU benchmarks, the limited number of proposed exemptions from the Regulation and the suggested transition measures that may need to be modified to better reflect market practicalities and risks.

21. With respect to bank structural reform, it is currently unclear how the EU's proposal would work in practice, not only in the context of the EU's BRRD, but also with respect to other international legislation. For example, EU subsidiaries of US banks are subject to the US Volcker Rule, but could also be affected by the EU's proposals in this area, and even the UK's ring-fencing. It is not yet known how Asian regulators will respond to these proposals. What is clear, however, is that the proposed changes would have a significant impact on EU banking institutions and their ability to meet the needs of their clients

22. Another area of risk of international inconsistency lies in the way local regulators will apply the provisions the BCBS/IOSCO margin requirements for non-centrally cleared derivatives[11], especially with regard to reuse of initial margin. We are concerned that this could be to the detriment of firms established and trading under the laws of EU Member States. If Europe does not wait for the US to implement the rehypothecation provisions and then follow with its implementation, there is a high risk that a pragmatic and globally consistent approach will not be achieved.

The shifting of activities to unregulated areas of the system is not a major threat to financial stability

23. As long as regulation is activity focused rather than entity focused, which is the approach that the FSB has taken, a shift of risks from the banking sector to non-bank credit providers is not a major concern in our view. Firstly, through its credit intermediation function, this sector provides an important source of alternative funding to the real economy. In our view, this function should be encouraged as part of efforts to develop a more diversified financial system with less reliance on bank funding, increased direct capital market financing and greater involvement of institutional investors and alternative financial markets. Additionally, a number of international and EU level initiatives are already underway to monitor and reduce the transfer and build up of risks in the non-regulated sector as a result of increased banking regulation. These rules include prudential oversight and resolution frameworks and will also ensure that regulated activities are not overly interconnected with this sector. These initiatives will be important to ensure that the same types of activities will be subject to the same types of rules, regardless of by who they are undertaken.

SECTION 3: THE EU SINGLE RULEBOOK AND THE CONSEQUENCES FOR THE SINGLE MARKET

Creating a single set of rules that is consistently applied throughout the EU is necessary to benefit fully from a Single Market for financial services.

24. There are still a number of elements required to consolidate the Single Market for financial services so that market participants are able to meet their clients' needs in the most optimal manner. For instance, differences and uncertainty generated by Member States' flexibility in transposing legislative requirements must be addressed. Going forward, we therefore favour the use of regulations over directives whenever possible, but we also need a current single regulatory framework for the financial sector that is uniformly applied across the entire EU. The establishment of the Single Rulebook is therefore paramount, but must go hand in hand with the development of an EBA Single Supervisory Handbook.

[11] Issued in September 2013

A number of measures should be taken to improve the role of ESAs and the level 2 rule making process

25. Overall, in assessing the balance of competences between Member States and the EU, it is important to acknowledge that the basic architecture for making the rules has generally been fit for purpose, and continues to have a key role. Nevertheless, we consider that there are a number of actions that can be taken to improve the process, particularly with respect to the European Supervisory Authorities (ESAs):

    a. The leadership capacity of the ESAs should be improved and enhanced by strengthening their independence, including from the European Commission and from national authorities[12].
    b. The emphasis of the ESAs' work, which to date has mainly focused on rule-making, should shift towards fostering convergence in supervisory practice. We therefore welcome the inclusion of this specific point in the recent Commission report to the European Parliament and Council.[13] It is necessary that the EBA's work now turns to the development of a comprehensive and coherent corpus of material articulating to an advanced level of detail the purpose, mode, approach, and manner of supervision of the full range of financial services issues and promoting a consistent supervisory culture. The Single Supervisory Handbook to be developed by the EBA under the Banking Union legislation is an important new formalised feature of the landscape in this regard. AFME attaches great importance to this issue and believes it needs strong resourcing.
    c. The level 1-level 2 relationship has not always functioned as it should and needs to be improved. We think that this could be achieved by ensuring greater clarity and certainty in level 1 texts and in mandates for the development of level 2 rules at the outset of the legislative process. The Commission has recently proposed that the role and influence of ESA staff within preparatory bodies could be reinforced[14]. We agree with this suggestion and believe that it can be achieved by involving the ESAs in the preparation of Commission mandates, allowing their participation as observers in technical discussions during the ordinary legislative procedure and asking for their opinion on the time necessary to deliver technical standards. Additionally, the ESAs could produce an initial timeline for the implementation of the level 1 rules and conduct periodic reporting on how the rule-making process is being implemented between level 1 and level 2 to ensure quality control. Lastly, the ESAs should also be able to implement a mechanism for pause in the process of their rule-making when deadlines are not realistic.
    d. An important challenge for the ESAs will be to ensure that the development of the Single Rule- and Handbooks do not become confused with undue prescriptiveness. While eliminating unjustified differences between the rules and practices of different jurisdictions is essential, this is a different matter from reducing the role of supervisory judgement.
    e. This could be improved by conducting cumulative, net impact assessments. We welcome the Commission's proposals to enhance the transparency of the ESA's process for

[12] We provided further suggestions on how this can be achieved in our January 2014 response to HM Treasury's Balance of Competences Review

[13] Report from the Commission to the European parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS), (COM(2014) 509), page 12

[14] Idem, page 12

preparing draft technical standards and advice and its recognition of the need for high quality cost/benefit assessment in these processes[15]. The ESAs should indeed conduct cumulative, net impact assessments as a matter of course. Their dialogue with market participants could also be further improved by organising it into two distinct layers: the high-level representation of wide interests that can be obtained and structured within the Stakeholder Groups and a technical dialogue that would benefit from the expertise in specific practices areas. It may be necessary to review the selection criteria and process for appointment to the Stakeholder Groups and to more systematically involve technical consultative groups, composed of relevant subject experts. Nevertheless, while interactions between Stakeholder Group and ESAs are important, these should neither be taken as a substitute for public consultation, nor as exhausting the technical dialogue with market participants.

f. Lastly, the ESAs' role in helping deliver an international level playing field for financial services should be significantly enhanced. This includes providing them with the resources and authority to take the leading role in equivalence determinations, relevant international discussions, and cross-border convergence. A proposal for enhancing the leadership capacity of the ESAs in international discussions could include entrusting the ESAs with adequate powers to ensure that they have the ability to interact at arm's length with third-country regulators (for example, by giving a leading role in the EU-US Financial Market Regulatory Dialogue, and enhancing their visibility and "voice" in international bodies).

AFME contact

Jacqueline Mills, jacqueline.mills@afme.eu +44 (0)20 7743 9538

[15] Idem, page 12