NORDIC SECURITIES ASSOCIATION

M E M O

Position Paper

Date
14 March 2016

Contact Helle Søby Thygesen
Direct +45 3370 1092
hst@dbmf.dk

File No 152/24
Doc. No 550313-v1

CMU – an impact assessment (call for evidence and Better Regulation)

On 30 September 2015, the Commission requested input from the financial sector on the overall financial legislation under the title "Call for evidence: EU regulatory framework for financial services". This consultation is part of the CMU Action Plan.

The consultation is closely related to the Better Regulation agenda published by the Commission on May 19th 2015. Although not a part of the CMU, the Better Regulation agenda ultimately seeks to promote growth and jobs in Europe. On December 15th 2015, the Commission endorsed a draft Inter-Institutional Agreement (IIA) on better law-making with the Council and the European Parliament. The IIA is currently awaiting final approval.

Better Regulation requires more and earlier stakeholder involvement

The NSA wholly agrees with the Better Regulation agenda in that new regulation and revision of current legislation should seek to promote growth and jobs in Europe whenever possible. Lawmakers must focus on the areas where regulation can add the most value; the EU needs to be big on the big things and smaller on smaller things.

We are concerned to see that an increasing part of the regulation is being pushed from level 1 to level 2 in order to achieve political agreements on level 1. This creates tensions in the level 2 process. MiFID2/MiFIR is a good example.

The principles of the Better Regulation agenda should be applied to the existing body of law as well as the proposals that are currently being negotiated such as the Banking Structural Reform (BSR) and Capital Markets Union (CMU).

Although we fully support the effort of the Commission to conclude the IIA with the European Parliament and the Council, the principles in the Better Regulation agenda should not be restricted to the three major EU institutions. Rather, the principles should apply to all regulating entities in the EU and in Member States, including those responsible for drafting secondary rules such as the European banking Authority (EBA) and the European Securities and Markets Authority (ESMA).

Even though we have a strong and good relationship with the Commission and ESMA, we have a few suggestions to improve the relationship:

More stakeholder inclusion is needed – both in the level 1 (and also the trilogue) but certainly also in the early drafting of level 2 regulation (and level 3), since these levels have an increasingly great impact on businesses.

It is difficult to comprehend what kinds of secondary legislative acts are underway. And stakeholders, who are affected by the legislation, are only involved to a limited extent.

Therefore, more openness and dialogue is needed when ESMA (and EBA) draw up secondary legislative acts in the financial area. This would put investment firms in a better position to adapt to the new rules in good time and it would also be possible to highlight potential unforeseen consequences at an earlier stage.

We propose the following for the level 2 process:

- National FSAs should not be prohibited from or limited in discussing drafts with national stakeholders, since these can provide valuable and needed input to qualify the discussions
- A more open attitude in all phases of the legislative process
- More frequent and focused consultations and/or
- Longer consultation deadlines

Resources for ESAs should be safeguarded

The ESAs need additional resources and sustainable long-term financing to be able to fulfil their tasks, including better regulatory process and ensuring consumer and investor protection. The ESAs are independent agencies of the EU and should be treated as such. If the co-legislators and the Commission increase the workload of the ESAs without taking into account the resources available, this would jeopardize their independence. We therefore have the view that the Commission should explore options for new sustainable long-term financing of the ESAs, with the aim to safeguard their independence.

Furthermore, it is of vital importance that there is better consistency between the work of the ESAs and the legislation decided by the co-legislators. For example, guidelines from the ESAs should not go beyond the level 1 provision, and should respect the scope of different legislations.

Call for Evidence is a very important tool in ensuring an efficient CMU

The NSA believes the following items should be the focus in order to ensure a successful CMU.

Liquidity must be safeguarded

Liquidity in financial markets is of particular concern to us. The decline in market liquidity in all markets is worrying. A market is liquid when it is possible to trade a large order at any point in time with minimal or no market impact. Ensuring market liquidity is crucial for both financial stability and economic growth. Liquidity is a prerequisite for stable and effective financial markets. Low liquidity

discourages investing and increases the cost of capital, which in turn harms those who need the capital, i.e. the SMEs.

Taken together, regulations introduced recently and those in the pipeline have had the effect of financial market participants withdrawing from some important functions such as market making as the costs of these functions have increased considerably. This has impaired the liquidity in important markets. At the same time, the demand is unchanged or increasing.

The regulations concerned are markets regulation such as MiFID II/MiFIR, CSDR etc. as well as prudential requirements in CRD4/CRR and BRRD. We believe it is necessary and rather urgent to go through the combined effect of these regulations and see whether there are any unintended negative consequences for liquidity on important markets.

Financial Transaction Tax (FTT) is poison for the CMU

The implementation of a Financial Transaction Tax (FTT) will increase costs for both investors and issuers, impair functioning of the financial markets and drive market functions to less taxed countries. Overall, the tax would weaken financial markets in EU countries and would counteract the goals of the CMU.

Importance of domestic and local capital for financing smaller companies (– there is a limit to cross-border investment

It is important to recognize the "home bias" when investing in smaller companies and therefore the dependency on local/national funding despite initiatives to increasing cross-border investment. Therefore, it is important that EU legislation does not hinder the development of local/national market.

The Norwegian Securities Dealers Association[1] has gone through lists of participation in equity placements for the last 4 years and categorized each individual investor as either domestic or international. In all they have data on 74 equity placements for listed companies in Norway of varying size.

The data show that there is a strong link between the size of the issue and the degree of international participation. In issues of less than 200 MNOK (22 MEUR), 80–100% of the issue is taken up by domestic investors.

Only when issues get above 75 MEUR does the international participation exceed 50% of the total issue.

The "home bias" tendency in terms of the link between size of the issue and international participation is assumed to be logical from an investor viewpoint based on two primary drivers: information asymmetry and liquidity. Investors' experience an information disadvantage in terms of information access and flow from smaller companies. In addition, smaller listed companies naturally have less liquid shares than larger companies. Lower liquidity is not attractive for in-

[1] http://vpff.no/eng

ternational investors and the combination limits the flow of capital across borders in smaller SME financing.

Reporting requirements are very demanding in aggregate

The regulations regarding financial sector reporting should be more efficient and overlapping reporting obligations should be avoided, as is the case with EMIR, MiFID and soon also SFTR.

Reporting obligations have increased substantially due to diverse regulations that affect the entire sector. In addition, European financial supervisors have in recent years issued several dozens of reporting standards that concern all companies as well. Requirements issued by different authorities are becoming increasingly overlapping and differently defined.

While it is very important that authorities have access to enough data of good quality we believe that at this juncture it is necessary to go over the reporting requirements as a whole and make sure that overlaps and inefficiencies are avoided. Also, for all reported data, the purpose of data collection should be perfectly clear, and its benefits should outweigh the costs.

A need to harmonize investor protection rules

A high level of investor protection and consumer access to investment products and the financial markets are fundamental. However, it is important to review and coordinate certain parts in the investor protection rules.

EU Regulations on investor protection contain partially overlapping provisions on the same investment products and retail investor services, and the provisions contradict one another. The Commission's original goal was to place various different types of investment products and service providers under uniform regulation. Thus, the same rules would have governed securities and life insurance policies, for example, or banks and insurance companies. This is a supportable idea.

However, in practice the regulation did not reach this goal, and now the same type of products can be reached by different rules. A number of interrelated financial regulatory reforms have been adopted in order to promote investor protection (e.g. MiFID2/MiFIR, PRIIPS, UCITS, TD and MAR). The regulation is not aligned and is the source of significant burdens and inefficiencies. The CMU should therefore establish a seamless disclosure regime that avoids unnecessary burdens for issuers while maintaining a high level of investor protection.

Significant barriers to entry for smaller actors

The amount of new regulation adopted is unprecedented in volume and scope. Understanding and complying with all of it in general necessitates a large organization, or the use of other entities to which certain functions are outsourced.

The amount of post-crisis regulation and the level of detail of these regulations together constitute severe barriers to entry for small entities or newcomers. This

means that competition decreases, which in turn may lead to less effective financial services being offered in the EU. Also, it unfortunately enhances the "too big to fail" problems.

One example concerns derivatives markets where regulations have had the effect of smaller companies reducing their hedging activities. Most of these moves are due to the fact that unit costs for derivatives contracts have multiplied due to recently adopted regulations. There is an obvious problem if risks that are now left unhedged do materialize in the future.

Unclear definitions in many regulations should be avoided
To avoid legal uncertainty and different interpretations in EU member states, important concepts must be defined in a clear way and decided at the right level, i.e. level 1. In recently adopted regulations such as MiFID II/MiFIR, EMIR and SFT this is not always the case and we believe this is not acceptable. One example is the important concept of undertaking which according to the Commission can cover more or less every entity/person.

As additional measures to promote an efficient CMU, we encourage:

Regulatory framework to support of further digitalization
For society in general, the digital transformation holds promises of improved efficiency, lower costs and increased growth. As we believe has been shown in the Nordic countries, banks and financial services providers have a key role to play for the broader digital development of society. To ensure the best possible framework for digitalization the regulatory framework should provide free and fair competition that enables all actors to explore new digital business possibilities on equal footing at a global level thus ensuring a level playing field. All regulation should be neutral towards technology to ensure that the advantages of digitalization can truly be utilized.

Homogenous, international rules
As regulations adopted post-crisis differ globally, they have resulted in differing requirements for a number of important cross-border financial market activities. This is costly for the economies as different requirements have a general effect of fragmenting economies, which in turn is leading to unnecessary funding constraints in Europe. We believe this is unfortunate and that it should be avoided to the extent possible.

It is also important to ensure that EU interests are fully taken into account in the international regulatory processes within IOSCO, BIS and FSB. A limited number of EU Member States are part of the BIS and its committees and the FSB. Yet, all member states are expected to follow their decisions. This gives rise to challenges around certain European specificities not taken into account in international standards. Against this background, we believe that the EU must adopt a more proactive role within the relevant forums in the mentioned bodies. In addition, it is important for the worldwide regulation of securities markets that

IOSCO sets the standard and not a single country. A prerequisite for these requirements are to ensure proper and timely European coordination.