Brussels, 17 March 2017

EACB Response to the

EC Public consultation on the Capital Markets Union mid-term review 2017

March 2017

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 79 million members and 749,000 employees and have a total average market share of about 20%.

For further details, please visit www.eacb.coop

Introduction

The **European Association of Co-operative Banks (EACB)** welcomes the opportunity to participate in the **EC Public consultation on the Capital Markets Union mid-term review 2017**. We appreciate that the EC wishes to perform a stock taking exercise of the implementation of the CMU action plan with an aim to reframe it and complement it where necessary. To a large extend the targeted identification of a need for improvement of specific actions seems hardly possible at this point in time, as many of these initiatives have not yet been implemented and actual effects in the market cannot yet been fully assessed. However, an evaluation of the existing regulation of the capital market as part of the introduction of future rules and regulations would be advisable. We strongly support doing such assessment, which takes a holistic approach. It is necessary to avoid double regulation and inconsistencies and consider the cross- dependencies of financial market regulation (for example disclosure regime for issuers, cost transparency etc.). In doing so, it is important to strike the right balance between stability, investor protection, and performance of the financial markets.

We have already set forth examples and considerations on the EU Commission Green paper on Capital Markets Union[1], as well as to the EC Call for Evidence: EU regulatory framework for financial services[2] which remain valid.

Overarching messages

- **Liquidity:**

We fear that **MiFID II and the revised CRR provisions will limit the possibility of banks to engage in securities markets** and thus **reduce liquidity** in these asset classes substantially. Indeed, the burdensome limitations to engage in trading activities may reveal unintended consequences preventing banks from participating in securities markets (all forms of bonds and equities), as regulation pushes for a substantial reduction of the amount of securities in the trading book as well as in the banking book. The overburdening provisions/requirements included in the regulations, with their complexity, implementation challenges, administrative burden are likely to reduce demand for these securities and negatively impact the liquidity of the market, which may even prevent other investors, private or institutional, from engaging in (some) securities markets.

- **Compliance detail and compliance costs:**

The **regulatory compliance costs** resulting from the legislative package and its implementing measures generated, and continue to generate an increasingly **high burden** for all banks. The question arises whether these costs are still **proportionate** to the purpose the legislative package intended to pursue. This is even truer for smaller and medium sized co-operative banks for which the combined compliance cost start to become unbearable.

In the area of **retail banking**, more and more **product specific legislation** is introduced (at level 1) with ever high degrees of detail (at level 1 and 2). The side effect of such legislation is that cost-efficiency and compliance replace customer satisfaction as the primary driver for doing business. This results in reduced access to services (e.g. support of branch/ATM networks becomes too expensive), customer choice and innovation.

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[1] https://v3.globalcube.net/clients/eacb/content/medias/publications/position_papers/financial_markets/CMU/EACB_comments_on_CMU_final.pdf

[2] http://www.eacb.coop/en/news/eacb-news/eacb-provides-input-to-the-ec-call-for-evidence-eu-regulatory-framework-for-financial-services.html

- **Excessive formalism:**

Excessive formalism will potentially discourage (potential) investors from capital markets investments and drive banks to withdraw from their role as intermediaries due to cost and liability risks. We can already see today, that the combined effect of recent regulation is already leading to the limitation of certain services to retail clients. Many retail investors refrain from using the support provided by investment advice, and thus potentially miss important opportunities on capital markets. We fear that if legislation is not adequately calibrated and properly designed (e.g. product governance requirements), it could further reduce investment opportunities for retail investors. One concrete example is the new target market regime together with restrictive provisions for advisory and inducements.

- **Goldplating by national authorities and courts**

At the same time, **legal certainty** is important in order for banks to fulfil their function as intermediaries between investors and companies and all counterparties to be aware of their rights and obligations and exercise them or fulfil them accordingly. For example, we have seen that general provisions established in MiFID I and MiFID II in order to protect consumers and their national transpositions, are being used by national courts in certain member states to make an interpretations in a very overreaching way, going beyond the legal requirements and making a 'de facto' demand for the 'execution only' regime to involve activities (such as assessing suitability and/or appropriateness) which legally only concern other investment services such as investment advice and portfolio management. Moreover, these court rulings put the burden of proof exclusively on the investment firm side with very demanding and unrealistic requisites. As a result, investment firms have lost faith in their ability to effectively demonstrate their correct and lawfully conduct, no matter how true this is. This is leading in our view to **restrictions in the offer of products, due to litigation risk and legal uncertainty**. This outcome is highly detrimental not only for the industry, but also for investors and for citizens as a whole due to the limitations for the ability of the economy to finance itself and grow, which is an aim of the Commission which we strongly share. For that purpose, we consider that legislation should explicitly aim to include a 'safe haven' wording for investment firms so that their intermediation function is not severely hindered even if they comply with rules. There is an inherent risk to all financial investments that should be accepted as such irrespective of the investment services offered (be it execution only, investment advice, portfolio management, ...) and European law should take this point of view into account when trying to develop the CMU objectives.

- **Timing of implementation of legislation:**

Another important point that needs to be duly considered in the design of the regulatory framework is the **timing factor**. Adequate, realistic and legally effective implementation periods should ensure in future that the legislative acts of the different stages are coordinated with each other and that there is still sufficient time to implement the new regulations in time. Two recent examples show that this is not always the case. Both MiFID II and the PRIIPs Regulation are supplemented by comprehensive Level II measures, without which implementation cannot take place. Both legislative projects failed to adhere to the timetable envisaged, which led to considerable legal uncertainty and significant additional costs. In order to avoid this in future and to ensure that Level 2 can be adopted appropriately and without time pressure, the implementation deadlines for the market participants should be based on the enactment of Level 2 (e.g. 12 months after publication in the Official Journal of the EU).

In the same vain, we would recommend that the **European Supervisory Authorities would need to have an instrument similar to no-action letters** - which are available to most other financial markets regulators-in order to improve the speed with which it can **respond to pressing issues and ensure supervisory convergence**. Experience has shown that this is necessary under specific circumstances (e.g. the case of quickly evaporating liquidity) in order to avoid market disruptions. The kick- in of the EMIR margin requirements on 1st March 2017 clearly shows this necessity.

- **Diversity of the banking sector:**

And finally, there are powerful systemic benefits that derive from the **diversity of business models** and the **ownership structure in the banking sector**. These benefits are notably increased competition and higher resilience. When firms operate with different incentives and goals, the competition for the customer will be even more intense as based on different ways to serve them. This improves **consumer choice** and **innovation**. At the same time, it contributes to the system being more **resilient:** when there is a shock such as the global financial crisis, firms with different business models are affected in different ways and will react differently. The **regulatory and supervisory framework** should ensure that the diversity of the banking sector is preserved and in doing so that also **co-operative banks** and **building societies** are able to continue fulfilling their important role in the economy, especially for the **financing of households** and **SMEs**. The specific business models of these entities, mandates a design of rules that are fit to purpose. Business models should be factored in consistently throughout supervision, regulatory practices and approaches, as well as in recovery and resolution strategies. A "one size fits all" approach for all banks, irrespective of the size, business model and activity can cause distortion.

Please find below some further considerations of the EACB with regards to some specific consultation Questions.

EACB Specific Comments:

1. FINANCING FOR INNOVATION, START-UPS AND NON-LISTED COMPANIES

- The EACB sees the SME sector as a major contributor to growth and employment in the EU. Despite the continued challenging environment that impacts SME financing and the restrictive legislative framework out in place, banks continue to fulfil their role as key financers of SME and most SME applications for loan finance are successful. Taking the commitment to SMEs a step further, the EACB is working on strengthening feedback provided to SMEs on their credit applications, keeping existing effective national frameworks in mind. In this context it has been working closely 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.

- In general the EACB welcomes the EC support of market initiatives in the field of private placements and the fact that corresponding financing instruments for companies are not to be encumbered by new regulations.

Having said that, we consider that an appropriate regulatory framework for institutional investors to invest substantially in tools like VC-funds (a FoFs), EuSEFs, ELTIFs or Private Placements is still missing:

- The stronger role financial intermediaries like UCITS or AIFs could play in using these tools has not been captured yet.
- Restrictions in different regulatory frameworks (e.g. UCITS, AIFMD, MiFID II ....) will still prevent institutional investors/experienced private investors from engaging more in asset classes like corporate bonds or Private Placements.

2. MAKING IT EASIER FOR COMPANIES TO ENTER AND RAISE CAPITAL ON PUBLIC MARKETS

• Regarding the draft Prospectus Regulation, we have well taken note that that agreement between the trilogue partners on the legal text has been reached and this was done in a relatively fast manner. In principle, this is to be welcomed. However, the rapid process has resulted in a large number of substantive requirements not having been defined in the Regulation itself and they will now have to be defined at Level 2. We fear that a great deal of time will have to be invested in detailed work on the Level 2 texts and that the Prospectus Regulation will take effect without regard for the actual progress of work on the Level II texts. As stated above, we see a danger that complex worl on level-2 measures on this piece of legislation could lead to problems comparable to those with PRIIPs and MiFID II. And it is a real challenge to make an offering document as a prospectus readable for retail investor.

We consider it to be preferable that the most important requirements of the Regulation can already be defined in Level 1 text as possible, rather than having a large number of Level 2 texts.

At the same time, we consider that the Prospectus revision was not as ambitious as the EACB members would have hoped for. For example certain key provisions alleviate burdens only for listed companies and not co-operative banks, whereas there are no objective reasons for doing so.

• The extension of the scope of issuers' duties under MAR to companies listed on MTFs may produce a considerable burden for smaller issuers – as small co-operative banks – which trade exclusively their own bonds on such venues.

MTFs are used both by SMEs, for access to markets, and small banks to raise funds for financing SMEs. To boost this mechanism it would be necessary to relieve the burden on small issuers as small co-operative banks. The higher cost of funding will necessarily reflect on the cost of financing.

Smaller issuers including small co-operative banks which trade their securities only on MFT would find themselves subject to the same rules applicable to issuers of securities listed on regulated markets. In particular, it would entail "disclosure price sensitive information", which in essense is not required for achieving the purpose of the Regulation. Indeed, when it comes to the effectiveness of the information to be disclosed to the public, it is important to consider the following : In equity markets (particularly volatile) prices of financial instruments are more exposed to the influence of information about the firm. Instead, when it comes to the bond market, it must be considered that the price of bonds, less subject to volatility, is a function of the financial variables existing per se within the instrument itself, rather than of the information about the firm.

Overall there is a need to effectively reconcile the needs of protecting the integrity of the markets with sustainability of the burden imposed on market participants and their functioning in particular when it comes to smaller players such as SMEs and small banks.

Moreover, the minimum threshold for managers' transactions communications is too low. The additional costs arising from the disclosure requirements may discourage trading on MTF entailing in fact a reduction of the solutions used by co-operative networks to strengthen the liquidity of financial instruments, which otherwise would not be available, or would be less effective.

3. INVESTING FOR LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT

Sustainable Finance should remain a market driven process, in order to avoid an abrupt and undifferentiated regulation risking a shock of transition. Measures to scale the green and sustainable finance market include developing broad, voluntary principles and a common green language and vocabulary that is not legalistic at least not at this point in time. Indeed, avoiding a "one size fits all approach" is key since a single definition risks not adequately reflecting contexts and priorities in different countries or markets.

4. FOSTERING RETAIL INVESTMENT AND INNOVATION

As a first approach towards a more competitive and transparent market on retail financial services within the EU we believe it to be appropriate to stabilise the present legislative environment first. This should be done by assessing the impact of post-crisis legislation, as many EU directives adopted recently (e.g. the Mortgage Credit Directive, Payment Accounts Directive, PRIIPs, MiFID etc.) will achieve the addressed objective of more competition on national markets in terms of better choice, price and transparency. It is therefore necessary to give first sufficient time for the measures to be effective in the first place and not to over-regulate the markets by taking additional actions.

Furthermore, any proposals made should be subject to a comprehensive impact assessment and only be taken into account if the assessment indicates that a positive net effect is to be expected. Indeed, the EC should pursue its better-regulation approach, before considering proposals for new regulatory measures. It is essential, when considering any regulatory measure, to weigh the time and cost of implementation – which any form of regulation inevitably involves – against the additional benefit it will deliver. It is important when considering any regulation to respect the principle of proportionality in order to avoid excessive regulatory burdens having structural policy ramifications – especially for small and medium-sized banks, and to weigh the extent to the implementation is commensurate with the additional benefit. Over-regulation should be avoided. Each bank should be free to decide, in its responsibility for its own business policy and offering to clients.

In addition, efforts to promote integration should not compromise the viability of existing business models geared towards regional markets, for example. There should, for instance, be no obligation whatsoever for every supplier to provide his or her products in every official language of the EU. It should be left tosuppliers themselves to define their own target market.

Furthermore, barriers are caused not by problems such as a lack of digitisation and innovation in the financial sector but by the lack of an adequate legal framework for offering services across borders. There is, for example, no recognised EU-wide procedure for verifying the identity of customers from another member state who wish to open an account.

Established banks are also investing in the digitisation and innovation of financial products and there are many cases of cooperation and collaboration between banks and fintechs. In the interests of a level playing field, it is important that banks and fintechs are subject to the same regulatory requirements, especially where fintechs offer financial products and services independently. Otherwise, competition will be distorted, leading to a negative impact on consumer protection.

5. STRENGTHENING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY

- We welcome the statement in the consultation document that loan financing by banks is complementary to financing by the capital market. For the vast majority of companies in Europe and particularly for SMEs, bank lending is and remains the main source of financing. It is therefore still of crucial importance to shape corporate financing by credit institutions in such a way as to ensure financial stability without restricting lending to companies. Successful capital market financing is also often based on the intermediary role of banks. This role should therefore not be undermined or disrupted – by or parallel to the Capital Market Union.

For most SMEs, capital market financing is not an option because of the strict requirements (such as minimum volumes, reporting requirements) and costs. An arbitrary promotion of capital market financing at the expense of the lending industry carries the risk of bypassing the needs of businesses, leading to the development of shadow banking activities.

- We welcome the initiative to create an STS-regulation to foster the European securitisation market. Nevertheless, as the European co-legislators have now each proposed their own approach on the initiative and the trilogue has started, we have some concerns that the proposals might not end up helping the European securitisation market. Some proposals (and in particular the ECON-report) add a lot of requirements on top of the Basel and EBA considerations. Indeed, even though European securitisations performed very well during the financial crisis and even though the STS-label is for simple, transparent and standardized securitisations, the risk weights, the floor and maybe also the risk retention rates will be increased significantly. We are concerned that these additional burdens will thwart the original purpose of this initiative – to revive the securitisation market. Adding requirements in combination with double (STS) or even triple (Non-STS) risk weights will significantly disincentive banks to use securitisation.

Just to give you an idea, on the basis of IRBA securitisation transactions in the past two years, our members have calculated the (capital) cost effects of the proposed requirements: The results show that costs increase between 30% (for portfolios which may be considered STS) and more than 60% for a Non-STS portfolio.

Furthermore, the STS-label as proposed, will lead to major uncertainty. There are too many ambiguous criteria that have to be fulfilled to be STS and there is no authority, that will confirm in advance whether a securitisation is eligible for STS or not. Therefore, an originator using the STS-label is in danger that his or her assessment of a criterion is wrong due to the ambiguity, which even could result in sanctions and withdrawal of the STS-label after issuance. This would not only damage the reputation of the originator, but also the STS-label itself. For that reason, the originator should at least obtain the right to request a confirmation from the competent authority based on an own assessment that the securitisation complies with the requested criteria. This would only be a confirmation with regard to the requested STS-criteria, but no certification of STS-compliance of the securitisation. It would contribute to significantly increasing the level of certainty for originators.

In addition, there should be no public disclosure of data about investors, as it will dissuade them to invest and might conflict with data protection laws. With Brexit in mind, we kindly ask not to be more burdensome than international standards, as the UK is an important player in securitisation and might attract European business, if it will not implement an equivalent to the European regulation after Brexit.

- Fostering the development of a capital market for handling NPLs with the aim to free additional resources for lending is a sensible proposal. This, however, should be done keeping in mind that NPLs' treatment and disposal, especially from a supervisory point of view, must respect the proportionality principle: i.e. institutions with low stocks of NPLs should not be unnecessarily burdened by additional administrative requirements.

6. FACILITATING CROSS-BORDER INVESTMENT

Despite the Financial Collateral Directive and the Finality Directive – both of which include rules governing the protection and/or recognition of close-out netting, the legal framework for close-out netting still diverges across the various member states. A more extensive harmonisation of the legal framework, supporting the effectiveness and enforceability of netting agreements (especially in the form of contractual netting agreements contained in master agreements or in the rules and regulations of central counterparties), would be an important step to strengthen netting agreements as a key tool for mitigating risks in financial transactions. This applies all the more since recent regulatory initiatives (CRR, EMIR, BRRD, and SFT) increase the need for collateral. This presupposes a robust, uniform EU-wide legal framework for handling financial collateral(particularly in connection with cleared and non-cleared OTC derivatives) and close-out netting (segregation of client collateral, effectiveness of close-out netting as the basis for calculating the regulatory collateral, etc.). When continuing to develop the legal framework for close-out netting, the UNI-DROIT netting principles recently adopted (in coordination with the European Commission) should be taken into account.

Moreover, a potential measure to enhance collateral flow is to explicitly exempt collateralized trades from taxation (uncollateralized exchange of liquidity). Due to the low risk, low margin and high volume nature of the securities financing business (repos and securities lending) these are particularly vulnerable to external cost.

The FCD requires member states to remove obstacles to smooth provision of financial collateral. However, in some countries domestic tax legislation contains significant uncertainties with respect to transfer of title collateral.This is a clear obstacle for efficient use of transfer of title collateral.

Contact:

The EACB trusts that its comments will be taken into account.

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