BANKING AND FINANCE

Call for evidence: EU regulatory framework for financial services

Fields marked with * are mandatory.

Introduction

The Commission is looking for empirical evidence and concrete feedback on:

- A. Rules affecting the ability of the economy to finance itself and growth;
- B. Unnecessary regulatory burdens;
- C. Interactions, inconsistencies and gaps;
- D. Rules giving rise to unintended consequences.

It is expected that the outcome of this consultation will provide a clearer understanding of the interaction of the individual rules and cumulative impact of the legislation as a whole including potential overlaps, inconsistencies and gaps. It will also help inform the individual reviews and provide a basis for concrete and coherent action where required.

Evidence is sought on the impacts of the EU financial legislation but also on the impacts of national implementation (e.g. gold-plating) and enforcement.

Feedback provided should be supported by relevant and verifiable empirical evidence and concrete examples. Any underlying assumptions should be clearly set out.

Feedback should be provided only on rules adopted by co-legislators to date.

Please note: In order to ensure a fair and transparent consultation process **only responses received through our online questionnaire will be taken into account** and included in the report summarising the responses. Should you have a problem completing this questionnaire or if you require particular assistance, please contact fisma-financial-regulatory-framework-review@ec.europa.eu.

More information:

- on this consultation
- on the protection of personal data regime for this consultation

1. Information about you

* Are you replying as:

- ○ a private individual
- ● an organisation or a company
- ○ a public authority or an international organisation

* Name of your organisation:

International Council of Securities Associations

Contact email address:

The information you provide here is for administrative purposes only and will not be published

peisenhardt@iiac.ca

* Is your organisation included in the Transparency Register?
(If your organisation is not registered, we invite you to register here, although it is not compulsory to be registered to reply to this consultation. Why a transparency register?)

- ○ Yes
- ● No

* Type of organisation:

- ○ Academic institution
- ○ Company, SME, micro-enterprise, sole trader
- ○ Consultancy, law firm
- ○ Consumer organisation
- ● Industry association
- ○ Media
- ○ Non-governmental organisation
- ○ Think tank
- ○ Trade union
- ○ Other

* Where are you based and/or where do you carry out your activity?

United Kingdom

* Field of activity or sector (*if applicable*):

at least 1 choice(s)

- ☐ Accounting
- ☐ Auditing

- [x] Banking
- [ ] Consumer protection
- [ ] Credit rating agencies
- [ ] Insurance
- [ ] Pension provision
- [x] Investment management (e.g. hedge funds, private equity funds, venture capital funds, money market funds, securities)
- [ ] Market infrastructure operation (e.g. CCPs, CSDs, Stock exchanges)
- [ ] Social entrepreneurship
- [ ] Other
- [ ] Not applicable

Important notice on the publication of responses

*Contributions received are intended for publication on the Commission's website. Do you agree to your contribution being published?
(see specific privacy statement)

- (●) Yes, I agree to my response being published under the name I indicate (*name of your organisation/company/public authority or your name if your reply as an individual*)
- ( ) No, I do not want my response to be published

2. Your feedback

In this section you will have the opportunity to provide evidence on the 15 issues set out in the consultation paper. You can provide up to 5 examples for each issue.

If you would like to submit a cover letter or executive summary of the main points you will provide below, please upload it here:

- **877dda2d-b8f9-47c5-bb31-a1f14c343fd1/ICSA response to EU consultation - Cover Note.pdf**

Please choose at least one issue from at least one of the following four thematic areas on which you would like to provide evidence:

A. Rules affecting the ability of the economy to finance itself and grow

You can select one or more issues, or leave all issues unselected

- [ ] Issue 1 - Unnecessary regulatory constraints on financing
- [x] Issue 2 - Market liquidity

- [ ] Issue 3 - Investor and consumer protection
- [ ] Issue 4 - Proportionality / preserving diversity in the EU financial sector

Issue 2 – Market liquidity

Please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on market liquidity. Please elaborate on the relative significance of such impact in comparison with the impact caused by macroeconomic or other underlying factors.

How many examples do you want to provide for this issue?

(•) **1** example ( ) **2** examples ( ) **3** examples ( ) **4** examples ( ) **5** examples

Please fill in the fields below. For any additional documentation, please use the upload button at the end of the section dedicated to this issue.

Example 1 for Issue 2 (Market liquidity)

* **To which Directive(s) and/or Regulation(s) do you refer in your example?**

Please select at least one item in the list of the main adopted EU legislative acts below.
Please do not tick the "other" box unless the example you want to provide refers to an legislative act which is not in the list (other adopted EU legislative acts, national legislative acts, etc..). In that case, please specify in the dedicated text box which other legislative act(s) the example refers to.

- [ ] Accounting Directive
- [ ] AIFMD (Alternative Investment Funds Directive)
- [ ] BRRD (Bank recovery and resolution Directive)
- [ ] CRAs (credit rating agencies)- Directive and Regulation
- [x] CRR III/CRD IV (Capital Requirements Regulation/Directive)
- [x] CSDR (Central Securities Depositories Regulation)
- [ ] DGS (Deposit Guarantee Schemes Directive)
- [ ] Directive on non-financial reporting
- [ ] ELTIF (Long-term Investment Fund Regulation)
- [x] EMIR (Regulation of OTC derivatives, Central Counterparties and Trade Repositories)
- [ ] E-Money Directive
- [ ] ESAs regulations (European Supervisory Authorities)
- [ ] ESRB (European Systemic Risk Board Regulation)
- [ ] EuSEF (European Social Entrepreneurship Funds Regulation)
- [ ] EuVECA (European venture capital funds Regulation)
- [ ] FCD (Financial Collateral Directive)
- [ ] FICOD (Financial Conglomerates Directive)
- [ ] IGS (Investor compensation Schemes Directive)
- [ ] IMD (Insurance Mediation Directive)
- [ ] IORP (Directive on Institutions of Occupational Retirement Pensions)
- MAD/R (Market Abuse Regulation & Criminal

- [ ] Life Insurance Directive
- [ ] MCD (Mortgage Credit Directive)
- [x] MiFID II/R (Markets in Financial Instruments Directive & Regulation)
- [ ] Omnibus I (new EU supervisory framework)
- [ ] PAD (Payments Account Directive)
- [ ] PRIPS (Packaged retail and insurance-based investment products Regulation)
- [ ] Qualifying holdings Directive
- [ ] Reinsurance Directive
- [ ] SFD (Settlement Finality Directive)
- [ ] Solvency II Directive
- [ ] SSM Regulation (Single Supervisory Mechanism)
- [ ] Statutory Audit - Directive and Regulation
- [ ] UCITS (Undertakings for collective investment in transferable securities)
- [ ] Sanctions Directive)
- [ ] MIF (Multilateral Interchange Fees Regulation)
- [ ] Motor Insurance Directive
- [ ] Omnibus II: new European supervisory framework for insurers
- [ ] PD (Prospectus Directive)
- [ ] PSD (Payment Services Directive)
- [ ] Regulations on IFRS (International Financial Reporting Standards)
- [ ] SEPA Regulation (Single Euro Payments Area)
- [ ] SFTR (Securities Financing Transactions Regulation)
- [ ] SRM (Single Resolution Mechanism Regulation)
- [ ] SSR (Short Selling Regulation)
- [ ] Transparency Directive
- [ ] Other Directive(s) and/or Regulation(s)

* **Please provide us with an executive/succinct summary of your example:**
(If applicable, mention also the articles of the Directive(s) and/or Regulation(s) selected above and referred to in your example)

Liquidity is an essential element of well-functioning markets, being key to price discovery; execution; cost of capital; cost of dealing; investor confidence and risk appetite; risk management; and market stability and resilience.

There is broad acceptance that market making is vital to functioning of efficient markets, as it promotes investor confidence, moderates volatility, and strengthens resilience to shocks. According to the BIS: "Market-makers are important providers of liquidity services. By committing their own balance sheets, they stand ready to act as buyers or sellers to complete client-initiated trades in the presence of transitory supply-demand imbalances."
Pullbacks by market-makers due to higher capital rules provide opportunities for other market participants, including high-frequency traders, to step in as liquidity providers. However, new providers will have fewer incentives to support market liquidity because they are not building client relationships driven by ancillary revenue opportunities. There has always been a strong expectation on the part of investors that underwriters of bonds make a commitment to secondary market making in their issues. Newer providers are characterised as having far less capital for holding positions than that of

banks and securities firms.

There are over 150,000 corporate bond issues in the European market, each with different credit risks, maturities, coupon, optionality, and terms. It is unrealistic to think that investors and day traders – with different skill-sets and priorities – could fulfil the function provided by dedicated market makers.

Critics have claimed that the industry has overstated the role of the market maker when commenting on liquidity. Some have pointed out that dealer inventories are a small percentage of the overall market, or that dealers had the capacity to step in more during recent stress periods. But the role of bond dealers was never to buy all the bonds all the way down. Investors are responsible for their positions, and absolute liquidity can only come from other long-term fundamental investors who are intermediated by dealers. Dealers are “buyers of first resort” and “in the business of moving, not storage”.

Transparency is important for price discovery and evaluating value, but is not an end in itself. Overly granular transparency can alert competitors of positions so market makers are vulnerable and less able to hold larger positions. This is particularly true in the case of infrequently traded bonds. Also, the costs in terms of resources and technology must be considered in evaluating enhanced transparency initiatives.

A challenge for policy makers, regulators, and market participants is to balance the imperatives of minimising risk and maximising transparency with maintaining the market making function.

Risk is increasingly being transferred from bank balance sheets to the market, reducing the threat of “too big to fail” and losses to the taxpayer.

In the words of Mark Carney: “ “The possibility of sharp, unpredictable changes in market liquidity poses a clear risk to financial stability, particularly when some market participants take liquidity for granted and crowd into trades in anticipation of central bank action.

A REDUCTION OF LIQUIDITY
Different signals. In recent months, several sharp corrections – including repeated flash crashes – have revealed contrasting liquidity in at least several markets, with periodic surges in volatility signalling reduced liquidity. More generally, market participants are worried about problems in executing large orders without a significant price impact and degraded immediacy on several markets.

* **Please provide us with supporting relevant and verifiable empirical evidence for your example:**
(please give references to concrete examples, reports, literature references, data, etc.)

A SQUEEZE EFFECT IS RESULTING FROM THE CONTINUAL INCREASE IN DEMAND FOR LIQUIDITY COMBINED WITH A SUBSTANTIAL DECREASE IN SUPPLY

Bond markets have grown dramatically as borrowers need new financing sources beyond banks. Collateral requirements have also grown sharply.

Enhanced regulation has ensured that banks and securities firms have greater capital and liquidity and less leverage and risk. Capital requirements have increased by ten times and liquid assets holdings have quadrupled. Bank derivatives trading is more tightly regulated, proprietary trading is largely eliminated, and securities financing trades are subject to stricter leverage and capital rules. However, this makes for less ability to hold and hedge inventories and maintain a team of experienced trading and sales staff. Some large banks have exited segments of the market.

In the words of Mark Carney, “the combination of new prudential requirements on dealers and structural changes in markets has reduced market depth and increased potential volatility.”

Liquidity is difficult to both define and measure. A simple interpretation is the ability of investors to transact on a timely basis in good size without significantly impacting price. It is important to gauge liquidity resilience as conditions change. Four measures:

- depth (ability to execute large trades)
- tightness (spread between bid and offer prices)
- immediacy (speed of execution)
- resilience (price reversion following disturbances).

The ratios of trading volumes to the size of markets (turnover ratios) for both government and corporate bonds have declined as trading volumes have not kept pace with increased issuance.

European corporate bond trading volumes have declined by up to 45% between 2010 and 2015. Block trades are becoming more difficult to execute without affecting prices. Corporate bond turnover ratios in Japan and China have declined by roughly one-third since the crisis.

The state of corporate bond liquidity is less clear in the U.S. The Fed notes that bid-ask spreads have remained low and measures of price impact of trades have been fairly stable. However, investment grade turnover has declined by roughly 50% since 2009 and trade sizes have declined. Some analysts view the narrow bid-ask spreads as having been influenced by greater agency trading (with market makers acting less as a principal), thus signalling less liquid markets.

What is universally agreed is that dealer inventories are down substantially. A decline of as much as 75% in U.S. dealer holdings of corporate bonds has been cited. While some challenge that figure given the inclusion of asset backed holdings and suggest closer to 40%, the fact remains that dealer participation is greatly diminished.

The general state of the markets is such that the BIS is now concerned about a potential complacency that masks underlying weaknesses. The CGFS released "Fixed income market liquidity", which finds liquidity more susceptible to disruptions. The report points to sudden stops of liquidity in key segments and a deterioration of market depth metrics.

Statistics aside, many professionals are voicing concerns about the state of liquidity when interviewed as part of market making and liquidity studies (e.g. ICMA's report on corporate bond secondary markets, and the PwC report / GFMA and IIF).

Recently, the IMF (Global Financial Stability Report) called for policymakers to adopt pre-emptive strategies to guard against the risk of liquidity evaporating.

Euromoney's Fixed Income Investors Survey (published January 2016) asked "How concerned are you that regulatory changes will further reduce bond market liquidity?" Of the 1,924 responses, 80% said that they were either very concerned (36%) or reasonably concerned (44%).

What brings the liquidity issue into full focus is the potential for less benign market conditions - including interest rates increases from near zero, widening credit spreads, and an easing of special monetary policy measures - which would mean increased selling pressure in a market that has grown to record size. Notably,

- Corporate bonds markets (and thus investor holdings) have almost tripled since 2000
- Market depth (outstandings as a percentage of GDP) exceeds 170% in developed economies
- Since the beginning of the millennium, emerging markets have increased from 5% to 30% of global issuance
- Mutual fund assets have increased by almost five times
- "Risk parity" strategies in equity/fixed income portfolios involving leveraging the fixed income component (assuming lower volatility) have grown sharply

Some have argued, therefore, that temporary factors are creating the perception of liquidity beyond market fundamentals, masking potential risks. Following the unwinding of QE or in a stressed environment, liquidity risks and market fragilities are likely to be revealed, with higher volatility the likely result.

*** If you have suggestions to remedy the issue(s) raised in your example, please make them here:**

1) Consider liquidity when reviewing the package of adopted and implemented legislation, including CRD IV/CRR

2) Consider how increasing capital charges under FRTB may result in further bank scale back from market making activities. FRTB has the potential

to create the wrong incentives when the risk of positions and their hedges are not adequately recognised.

3) Reject Financial Transaction Tax as counter to the goals of CMU as increased costs would act restrict liquidity and ultimately hamper economic growth.

4) Review further the pre- and post-trade transparency calibrations of MiFID II/R to ensure a more accurate reflection of the lack of underlying bond market liquidity and its volatile nature.

If you have further quantitative or qualitative evidence related to issue 2 that you would like to submit, please upload it here:

B. Unnecessary regulatory burdens

You can select one or more issues, or leave all issues unselected

- [ ] Issue 5 - Excessive compliance costs and complexity
- [ ] Issue 6 - Reporting and disclosure obligations
- [ ] Issue 7 - Contractual documentation
- [ ] Issue 8 - Rules outdated due to technological change
- [ ] Issue 9 - Barriers to entry

C. Interactions of individual rules, inconsistencies and gaps

You can select one or more issues, or leave all issues unselected

- [ ] Issue 10 - Links between individual rules and overall cumulative impact
- [ ] Issue 11 - Definitions
- [ ] Issue 12 - Overlaps, duplications and inconsistencies
- [ ] Issue 13 - Gaps

D. Rules giving rise to possible other unintended consequences

You can select one or more issues, or leave all issues unselected

- [ ] Issue 14 - Risk
- [ ] Issue 15 - Procyclicality

Useful links

Consultation details
(http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm)

Consultation document
(http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-documer

Specific privacy statement
(http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/privacy-statement_en

More on the Transparency register (http://ec.europa.eu/transparencyregister/public/homePage.do?locale=en)

Contact

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