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Hørings svar vedrørende EU-Kommissionens call for evidence: EU regulatory framework for financial services

Finansrådet har den 1. oktober 2015 modtaget e-mail fra Finanstilsynet vedrørende høring om EU-Kommissionens call for evidence: EU regulatory framework for financial services med frist for bemærkninger den 13. november 2015.

Finansrådet ser positivt på Kommissionens gennemgang af den eksisterende finansielle regulering og Kommissionens dagsorden om better regulation. Sådanne initiativer er efter Finansrådets opfattelse udtryk for en mere balanceret tilgang til regulering af finansielle virksomheder, som vil fremme skabelsen af vækst og arbejdspladser i EU uden at kompromittere den finansielle stabilitet.

Finansrådet har til brug for besvarelsen af Kommissionens call for evidence foreløbigt identificeret eksempler på udfordringer i den eksisterende finansielle regulering inden for følgende områder:

- Market liquidity
- Excessive compliance costs and complexity
- Reporting and disclosure obligations
- Definitions

Eksemplerne er afgrænset til vedtaget EU-regulering og er ikke udtømmende.

Konkrete eksempler

Nedenfor fremgår Finansrådets eksempler på udfordringer i den gældende EU-lovgivning.

Da eksemplerne er målrettet Finansrådets besvarelse af Kommissionens call for evidence, er disse udfærdiget på engelsk.

Issue 2 (Market liquidity)

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

Directive on markets in financial instruments (MiFID 2)

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Please provide us with an executive/succinct summary of your example:

It seeks to improve the competitiveness of EU financial markets by creating a single market for investment services and activities, and ensuring a high degree of harmonized protection for investors in financial instruments, such as shares, bonds, derivatives and various structured products.

Please provide us with supporting relevant and verifiable empirical evidence for your example:

Certain parts of MiFID 2 risk, depending on the exact calibration and implementation, standing in conflict with the aim of the Capital Markets Union because:

Too extensive transparency- and quoting obligations will hamper the secondary markets and thereby the ambition of increased use of capital markets as funding in the primary market.

The transparency- and quoting obligations apply to so-called liquid instruments, but the liquidity calibrations are too far-reaching and not in line with the political agreement on level 1. A substantial number of illiquid instruments will incorrectly be deemed liquid ("false positive"). This will compromise the functioning of the secondary markets which will not only be negative for investors (pension funds and insurance companies), who face difficulties to manage their portfolios if liquidity decreases and spreads widens, but also to the detriment for issuers on the primary market, i.e. corporates, governments due to the increasing cost of capital. The quoting obligation applies according to ESMA's proposal up to very large sizes which exposes market makers to undue risk.

The venues' monopoly power on market data (market data from venue A cannot be substituted with market data from venue B) prevent the creation of market data pricing based on reasonable commercial basis which limit the needed flow of information to end-users and the creation of Consolidated Tape(s).

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

Ensure that only truly liquid instruments are deemed liquid by introducing proper liquidity test as stated at level 1.

Ensure that the quoting obligation and pre-trade transparency requirement are below sizes that expose market makers and systematic internalisers to undue risks and, where available, takes the average value of retail investors into account as stated at level 1.

For market data a cost based price cap on the entire order book and post trade data in raw data format should be imposed (LRIC+). These measures will imply that pricing of market data to final consumers will be according to reasonable commercial basis, as new and existing data vendors (including trading venues) will compete by offering value added data products based

on the price regulated raw data from the trading venues. In short, regulating prices on raw data level will imply competition on processed data level and facilitate the construction of consolidated tapes.

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Issue 2 (Market liquidity)

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

CRD IV/CRR

Please provide us with an executive/succinct summary of your example:

Generally, the introduction of new regulatory measures in CRD IV/CRR have reduced liquidity and increased volatility in the global financial markets – even in formerly ultra-liquid markets such as the markets for US and German government bonds. The same trends have been observed in the European market for mortgage covered bonds. One reason is that, because of the LCR requirement, investors tend to keep the most liquid bonds, which in reality makes them less liquid. A lack of risk capacity and repo capacity among market participants has also contributed to reducing market liquidity. In general, the sales opportunities for bonds have deteriorated.

The short-term liquidity requirement of the CRR (LCR) has caused an increase in the costs of bond-funded lending, such as mortgage lending funded by covered bonds. This is due to the fact that most assets, except government bonds, are subject to a "liquidity premium" (in the form of a haircut).

In addition, the requirements for series sizes in some asset classes have contributed to differentiating the costs within the individual asset class. For example, the requirements for the series sizes of covered bonds used to fund loans secured by mortgages on real estate have led to price differences between covered bonds that are exclusively due to differences in series sizes.

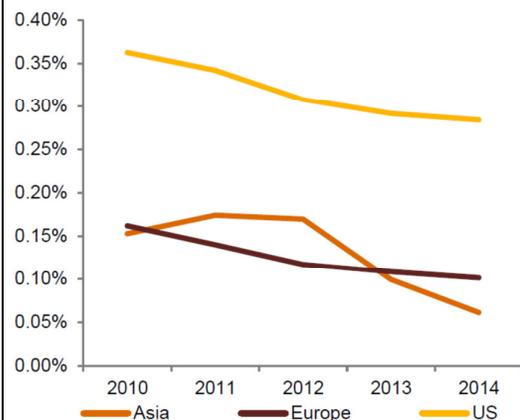
The costs related to holding repos have also risen considerably because a leverage ratio (LR) requirement is already factored in. The LCR also has an impact on mortgage banks' repo transactions running for more than 30 days. This is reflected in the reduction in repo market volumes observed recently. At the same time, there has been a distinct shift towards short-term repo transactions, or up to 30 days at the most.

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Please provide us with supporting relevant and verifiable empirical evidence for your example:

Figure 4: Corporate bond turnover ratios (average daily volumes/outstanding volumes)



Source: PWC "Global financial markets liquidity study"

The figure shows that the turnover for corporate bonds is falling worldwide.

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

Some of the regulatory measures in CRD IV/CRR have reduced liquidity and increased volatility in the global financial markets. This will reduce the European Banks ability to raise funding. This is not compatible with the aim of securing that the European banks can foster growth and employment in Europe.

Therefore, we find it essential that the evaluation of the impact of the new rules should be as comprehensive as possible and should also take into consideration the effect on the market liquidity in the financial markets. This is especially important when evaluating the effects of introducing the long-term liquidity requirements (NSFR) and potentially binding leverage ratio requirements.

Issue 5 (Excessive compliance costs and complexity)

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

Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property (Mortgage Credit Directive (MCD))

Please provide us with an executive/succinct summary of your example:

On December 18, 2007 the Commission presented a white paper on the integration of EU mortgage credit markets. The paper identified obstacles to integration of the markets and four objectives to strengthen competition

and effectiveness, including: Facilitating consumer confidence, including giving consumers a position to make an informed choice based on clear, comparable information and facilitating the cross-border supply and funding of mortgage credit.

On basis of this white paper, the MCD was decided on February 4, 2014 with a 2 year dead- line for implementation in member states.

Please provide us with supporting relevant and verifiable empirical evidence for your example:

ESIS: The MCD includes a standardized information sheet (ESIS). The purpose of ESIS is to give consumers a position to compare different loan offers. However, we fear that ESIS in practice is at a risk of working counter to this purpose – both due to the extent of ESIS and due to the character of some of the information included.

First, some of the information in ESIS seems to be of little value and in some cases even potentially misleading. An example of this is the calculation of an illustrative example on the APRC, according to ESIS part B, section 4(2). Where there is no cap the example shall illustrate the APRC at the highest borrowing rate in at least the last 20 years, or the longest period for which such data are available.

In general, it must be noticed that the use of historical data as a way of predicting future interest rates is a questionable method. Accordingly, the result will give limited value to the consumers. This limited value is in stark contrast to and does not measure up to the considerable costs for the banks to implement the method, i.e. costs for its development for the calculation and the storing of data.

Further, the method may cause significantly different APRC calculations in different banks, depending on the longest period for which each bank has the relevant data available. This could be very confusing for the consumers and work counter to the purpose of comparison.

Second, ESIS is very comprehensive. We assess that when all the relevant information is filled out in ESIS, ESIS will constitute approximately 11 pages. As such the mere extent of ESIS can be an obstacle for the consumers. If the consumers don't read ESIS, ESIS will not add any positive value. On the contrary, ESIS can contribute to information overload. Further noticeable, this will come at a very significant cost for the banks implementing ESIS.

In comparison it should be noticed that the Consumer Credit Directive (CCD) also includes a standardized information sheet (SECCI). However, to our experience, SECCI only comprises approximately 5 pages when it is filled out. Even though we understand that there might be a need for different information depending on whether the credit is secured by residential property or not, it could be advantageous to consider whether it really is suitable to more than double the information.

Foreign currency loans: In article 4(28) the directive contains a definition of foreign currency loans. According to this, a loan is a foreign currency loan if the credit is denominated in a currency other than the currency in application to the consumer's income, assets or residence. In practice, this definition will be very comprehensive (maybe a lot more comprehensive than it was intended to be), especially because not all member states have euro as the national currency.

Some examples:

- 1) A Danish person, living in Denmark, has a loan in DKK (Danish kroner), but has a salary in SEK (Swedish kroner)
- 2) A Danish person, living in Germany, has a salary in euro, buys a summer house in Denmark with a loan in DKK
- 3) A German person, living in Germany, has a salary in euro, buys a summer house in Denmark with a loan in DKK
- 4) A Danish person, living in Denmark, has a salary in DKK, owns a summer house in France, has a house in Denmark with a loan in DKK

All of these examples are, according to the definition, foreign currency loans. This will oblige the banks to ensure a number of things, according to MCD article 23, i.e. to ensure the consumer has a right to convert the credit agreement into an alternative currency or secure other arrangements to limit the exchange rate risk the consumer is exposed under.

Since these obligations can be very burdensome, difficult and unclear for the banks, a possible result is that the banks will restraint or limit the supply of foreign currency loans. If the banks should continue their supply at an unaltered level, the banks would in reality undertake an increased risk (the risk of the costs imposed on the banks when the consumers exercise their rights), which the banks would be compelled to include in their calculation of the price the consumer pays. Both of these scenarios would in fact work counter to the purpose of facilitating the cross-border supply and funding of mortgage credit.

It should be noticed that these consequences may appear not only in member states with another national currency than the euro, but also for member states where banks provide credits for consumers that may have income, assets or residence in another member state with another national currency than the euro.

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

We suggest that the Commission conducts an impact assessment regarding the MCD in general. It should be noticed, that an impact assessment was not carried out before the MCD was drafted. The impact assessment could be carried out on basis of input from member states to the extent that member states might have identified obstacles. Concrete examples could be ESIS and the definition of foreign currency loans.

With regard to the calculation of the illustrative example on the APRC, we suggest that the alternative APRC is calculated by increasing the actual interest rate by a certain fixed level, i.e. 5 or 10 percentage points, instead of using historical data. Such a calculation would not be of lesser value to the consumer than the current calculation; however, it would give the same warning effect as intended and give the consumers a better position to compare different loan offers. At the same time it would impose significantly reduced implementation costs on the banks.

Finally regarding foreign currency loans, we suggest that the definition is narrowed down. One solution is to delete one or two of the criteria; income, assets or residence. Another solution is to introduce a prioritisation between these three criteria. If none of the criteria is deleted it is necessary to clarify if and how the definition complies, if a consumer moves or changes job in the duration of the credit. Alternatively, it could be clarified how the banks can comply with the obligations.

Issue 6 (Reporting and disclosure obligations)

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

Regulation 575/2013 Article 99(2), reporting of financial information

Please provide us with an executive/succinct summary of your example:

The article requires institutions subject to Article 4 of regulation 1606/2002 (the IAS regulation) to report financial information on a consolidated basis under uniform formats, frequencies and definitions, the so called FINREP. However, the requirement represents minimum harmonization, as each member state can require additional information on consolidated basis. Further, each member state can require reporting at solo level deviating from the formats, templates and definitions used in FINREP.

Please provide us with supporting relevant and verifiable empirical evidence for your example:

The administrative burden posed on institutions to be able to report financial information both under FINREP and under national reporting schemes is significant in some member states.

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

Maximum harmonization should be applied instead of minimum harmonisation. Thus, if an institution applies FINREP at consolidated level the member state should not be allowed to require additional information on consolidated level. Similarly, an institution shall always have the option to apply FINREP at solo level, and if so the member state should not be allowed to require additional information on solo level either.

Issue 11 (Definitions)

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

MiFIR and Regulation (EU) No 236/2012

Please provide us with an executive/succinct summary of your example:

The definition of a short sale is not aligned in MiFIR and Regulation (EU) No 236/2012.

According to Regulation (EU) No 236/2012, "The relevant time for calculation of a net short position shall be at midnight at the end of the trading day on which the natural or legal person holds the relevant position". However, in MiFIR, it is stated that "the short sale has been concluded at the time of the execution of the transaction in accordance with Article 2(1)(b) of Regulation (EU) 236/2012".

It could be interpreted that the requirements are different. For example, if there is first a sale of a government bond, and immediately after that a similar-sized buy of the same instrument, this would result as a "short sale" reporting according to MiFIR, but would not be calculated as a short sale according to Regulation (EU) No 236/2012.

It is very challenging to implement a reporting setup that could calculate the legal entity level net short position for a security at any particular execution time during a day. This is potentially why Regulation (EU) No 236/2012 opted for an end-of-day calculation setup. The requirements should not be different, especially since MiFID2 explicitly refers to this regulation.

When reporting were the clients is short selling then Firms will have to rely on the clients accurately informing them of the fact that they are short selling. Notifications of customers' short selling positions are not a responsibility for the service provider/broker according to short selling regulation and there is no obligation to ask if customer is short or not according to short selling regulation. It could be questioned if customer can be responsible for providing short selling information to one or more individual brokers.

Please provide us with supporting relevant and verifiable empirical evidence for your example:

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

The definition of a short sale in MiFIR should be aligned with the definition in Regulation (EU) No 236/2012.

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Hvis ovenstående giver anledning til spørgsmål eller bemærkninger, skal Finanstilsynet være meget velkommen til at kontakte undertegnede.

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Med venlig hilsen

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