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on the Call for Evidence

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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

Call for Evidence - EU regulatory framework for financial services

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Staff Working Document on the Call for Evidence

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1. INTRODUCTION

1.1. Commitment to Better Regulation

The Commission Communication on “Better Regulation: Delivering better results for a stronger Union”, published on 14 September 2016¹, stated that well-targeted, evidence-based and simple regulation is more likely to achieve its goals. More effective regulation, which addresses European market failures, should also be proportionate, to avoid undue burden on citizens, businesses and public authorities. In effect, better regulation requires rules with a focus on their expected effects.

The Commission already evaluates the performance of existing EU regulation before assessing the potential impact of options for new rules and holds open public consultations to evaluate whether action already taken or options for future action are best taken at European level or the objective could be better achieved by Member States. Since 2003, when impact assessments became the norm, the Commission has prepared 975 impact assessments to support its proposals. Since 2010, the Commission has also run 704 public consultations and made 688 ex post evaluations of EU legislation. Evaluations, impact assessments and public consultations are essential ingredients of the Commission's Better Regulation agenda. Better regulation tools can deliver more proportionate rules and minimise unnecessary costs, as well as address interests and concerns identified by stakeholders and the general public.

Significant financial sector reforms have been achieved since the crisis, including the single supervisory and single resolution mechanism for the banking union, bank resolution tools, greater deposit protection, new supervisory authorities and an improved regulatory framework for banks, insurance companies, financial markets and other sectors. Overall, these reforms have made the financial system more resilient. Nonetheless, the complexity of this regulatory effort requires an overall assessment of its coherence and consistency with their ultimate objectives.

With the call for evidence, the Commission has taken its better regulation methodology a step further by looking across the entire body of financial services regulation and assessing interactions between individual pieces of legislation. In the spirit of the better regulation agenda, asking for evidence-based policy making, the call for evidence invited external stakeholders to provide data and practical experiences about the combined impact of rules. EU legislation should ultimately remain efficient, consistent and

¹ COM(2016) 615 final

coherent with the objective of balancing financial stability with a growth friendly regulatory framework that protects investors properly.

The call for evidence is in line with the European Parliament's Resolution "Stocktaking and challenges of the EU Financial Services Regulation: impact and the way forward towards a more efficient and effective EU framework for Financial". The results of this effort have fed into the work of international fora, such as the G-20, the Financial Stability Board, and the Basel Committee on Banking Supervision (BCBS), which are assessing the overall coherence of the reforms undertaken globally. The EU is the first jurisdiction to have launched such a comprehensive and structured approach in financial services regulation. The call for evidence gathers evidence to fine-tune the implementation of the post-crisis reforms in the light of initial experience, not to question the main aspects of the reforms.

1.2. The Call for Evidence and Capital Markets Union

The call for evidence complements one of the Commission's flagship initiatives, the Capital Markets Union (CMU). CMU aims to diversify the financial system with alternative funding tools to traditional banking services. It aims to complement bank funding in the EU with stronger capital markets. A more balanced distribution of financing sources should ultimately strengthen financial stability even further and facilitate the access of businesses to a source of financing that is most suited to their particular situation and needs. It should also create more and better opportunities for investors, deepen financial integration and increase competition in the financial services industry.²

The call for evidence aims at improving the quality of the current regulatory framework in financial services, including those that will be directly impacted by CMU actions. It was thus meant to verify that financial reforms do not unduly burden access to finance and that they are consistent across financial sectors and coherent in a way that major regulatory gaps are addressed. To address barriers to finance and unintended consequences, the call for evidence supports CMU actions with additional input to make appropriate adjustments to the regulatory framework.

1.3. Key messages

The call for evidence attracted a large amount of interest, with around 300 respondents having shared their observations and concerns. As summarised in the call for evidence

² See COM(2016) 601 final for more details.

Summary Feedback Statement³, around 80% of the responses came from the financial industry with the remainder, among others, coming from the public authorities, consumer organisations, NGOs, think-tanks and private individuals. In terms of number of issues raised, capital markets formed the second most prominent topic, following bank regulation. Many of the issues raised are closely aligned with the objectives of the CMU, such as facilitating better access to finance or reducing barriers to cross-border investments.

Overall, stakeholders did not dispute the fundamental aspects of the recent financial reforms. In fact, many expressed support or highlighted the benefits of the new rules, which have enhanced the stability and resilience of the financial system. Stakeholders welcomed this exercise as an important step in improving the existing regulatory framework to strike the right balance between economic growth and financial stability. Although the exercise originally focused on the legislation adopted by the co-legislators that is already in force, many responses were submitted on the possible impact of measures that are still being formulated (e.g. as regards the ongoing work of the BCBS). These were included in the report, but the evidence on the impact of rules not yet implemented is limited.

The call for evidence has proved to be very useful in drawing attention to examples of inconsistencies, overlaps and unintended interactions between different pieces of legislation. As set out in the consultation documents, the responses to the call for evidence were assessed against the following objectives:

- promoting economic and financial stability in the EU;
- maximising the benefits of the financial system to the economy, jobs and sustainable growth, and promoting better access to finance, notably for SMEs;
- completing the EU single rulebook and promoting the single market;
- restoring trust in the financial system and ensuring a high level of consumer and investor protection;
- ensuring the EU rules are as simple and clear as possible and keeping regulatory burden to the minimum necessary; and
- promoting competitiveness of the EU economy.

Based on a thorough review of all the consultation responses and the evidence provided, the public hearing in May 2016 and the subsequent analysis by the Commission services, it has concluded that follow-up actions are required in the following areas:

³ http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/summary-of-responses_en.pdf

- Greater attention should be paid to areas where rules may be impeding the flow of finance to the economy. Consideration needs to be made as to whether the same prudential objectives can be achieved in a more growth friendly way. (Chapter 2)
- There may be scope to increase the proportionality of the regulatory framework as part of the wider aim to better balance financial stability and growth objectives. Rules should recognise the diversity of financial institutions in the EU and should not create unintended barriers to new market players. (Chapter 3)
- Unnecessary regulatory burdens should be avoided, and rules designed that achieve their objectives at minimum cost for firms and, ultimately, end users and the wider economy. In particular, the burden stemming from duplications and inconsistencies of the various individual requirements should be assessed. (Chapter 4)
- Unintended interactions and inconsistencies need to be looked at with a view to addressing the remaining risks in the financial system, further enhancing investor trust and consumer protection and keeping the regulatory framework up to speed with technological development. (Chapter 5)

In addition to initiating new follow-up actions, notably to fill the remaining gaps in the regulatory framework, the additional insights and evidence gathered through this consultation will be used for several ongoing work streams, such as:

- Fitness checks and legislative reviews as part of REFIT, including on reporting requirements in the financial sector;
- Calibrating of the measures at both the legislative and implementation levels;
- Ongoing policy work, e.g. to refine and accelerate measures under the CMU Action Plan; and
- Commission input into efforts at global level to measure and evaluate the combined effect of reforms.

This Staff Working Document accompanies the Communication on the call for evidence which sets out the follow-up actions that the Commission intends to take. It provides background information for the Communication but does not contain any new policy commitment for the Commission beyond what is set out in the Communication.

2. REDUCING UNNECESSARY REGULATORY CONSTRAINTS ON FINANCING THE ECONOMY

The financial system plays an important role in helping households and firms to manage financial risks over time and execute payments, which contribute to make the environment more investment friendly. Post-crisis financial reforms aimed at strengthening the resilience of the financial system and its diversification to better withstand shocks that hamper access to finance, as during the financial crisis. Rules, however, can create unintended interactions that may impede the flow of finance to the economy. It is therefore important to assess whether rules can achieve the same prudential objectives in a way that minimises the impact on access to finance for firms and households.

This section reviews submissions arguing that EU rules may hinder access to finance in the following areas: banking activities (section 2.1); SMEs financing and long-term investments (sections 2.2 and 2.3 respectively); market liquidity (section 2.4) and clearing services (section 2.5).

2.1. Banks' ability to finance the wider economy

Firms and households in the EU remain highly dependent on banks' capacity and willingness to finance their investments and activities. While the Commission is working with the co-legislators to develop the CMU so as to broaden the sources of finance, it is imperative that the bank funding channel functions appropriately.

Most respondents agreed that the post-crisis reforms steered by the BCBS and implemented in the EU through the Capital Requirements Regulation (CRR)⁴ and the Capital Requirements Directive (CRD IV)⁵ were crucial in restoring the resilience of the banking sector. Such resilience is a pre-condition for banks to play their role in financing the economy. However, respondents also expressed concerns about the impact of upcoming prudential measures being finalised by the BCBS, and how they may interact with existing rules in a way that limits the financing capacity of banks.

Banks have raised over €800bn of capital since the financial crisis. The 2016 stress test of the European Banking Authority (EBA) also showed that Europe's banking system is

⁴ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

⁵ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

able to withstand severe shocks. The Commission's focus is now to implement the remaining BCBS reforms to address remaining risks in a way that ensures that banks maintain the capacity to support the growth of the EU economy.

Submissions focused on three major pillars of EU bank legislation: CRR, CRD IV and the Bank Recovery and Resolution Directive (BRRD)⁶. The first sub-section takes stock of issues raised in the context of prudential measures foreseen in the review of the CRR and CRD IV. The second sub-section assesses concerns about the way so-called "Pillar 2" bank capital requirement rules are applied. The third sub-section reflects on whether the prudential rules should be adjusted in light of the banking union, whereas the final sub-section considers concerns about a particular aspect of the bail-in regime under BRRD.

A) Prudential measures

In reaction to the financial crisis, governments, central banks as well as supervisors strengthened the international regulatory framework for banks through the Basel III reform agreed in 2010. In the EU, Basel III was implemented by means of the CRR/CRD IV package, which introduced stricter rules on capital requirements for banks and laid the ground for implementing the international standards on liquidity and leverage.

A large number of responses to the call for evidence concerned the CRR/CRD IV package including those that are currently under discussion internationally.

1. **Leverage ratio (LR) reduces diversity in the EU financial sector.** Respondents stated the LR endangers diversity in the EU financial sector by reducing the capacity of low-risk business models (e.g. public development banks, mortgage banks, banks with mainly sovereign exposures) to compete with higher-risk business models.
2. **Net Stable Funding Ratio (NSFR) impact on repo markets and market making activities.** Respondents argued that short term transactions with other financial counterparties, such as repo/reverse repo, would suffer from an asymmetric treatment under the NSFR Basel proposal. Short term borrowing transactions from financial counterparties receive a 0% Available Stable Funding (ASF) factor, whereas short term lending transactions with financial counterparties receive a 10% or 15% Required Stable Funding (RSF) factor. Respondents argued that this could be detrimental to the repo market and to market-making activities in the underlying

⁶ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

repo's collateral (sovereign bonds, corporate bonds, etc.) given that well-functioning repo markets are essential for banks' ability to manage liquidity and market-making related inventory, and therefore to the market liquidity of this underlying repo's collateral.

3. **NSFR impact on derivatives activities.** Respondents argued that the NSFR's lack of risk sensitivity and treatment of margins would penalise derivatives activities and reduce end-users ability to hedge risks. Respondents contended that this would result in important stable funding requirements for EU banks on their offering of risk hedging tools to credit institutions and end-users, including corporates, and hence may incentivise them to reduce the offer or shift additional costs to end-users.
4. **LR impact on clearing services:** Banks acting as clearing members argued that, if the LR were not to allow the initial cash margins received from clients to reduce the potential future exposure on the client leg of the centrally cleared client derivative transaction, then this would result in a disproportionate increase in capital requirements for this low margin business. They argued that this could adversely affect the provision of central clearing services to clients, which is contrary to the G20 objective of promoting central clearing (see also section 2.5).
5. **Trade finance under the NSFR/LR.** Respondents argued that trade finance loans are less risky than standard corporate loans, but this lower risk is not fully reflected in existing or forthcoming requirements. As regards the former, they expressed concern that some of the rules on how banks have to measure risks when using internal ratings-based (IRB) approaches unduly penalise trade finance. On the latter, they voiced concerns that neither the LR nor the NSFR would recognise the particular nature of trade finance, calling for specific adjustments, such as lower NSFR RSF factor or exempting trade finance from calculation of the LR.
6. **LR – Liquidity Coverage Ratio (LCR) interaction.** Some respondents referred to potential adverse interactions between the LR and the LCR. The LR penalises banks for holding High Quality Liquid Assets (HQLA), which are required by the LCR. While conceptually valid, the LCR and LR pursue different prudential objectives (liquidity and capital), which credit institutions have to meet in parallel. The EBA⁷ concluded in its report on the LR that correlations between the LCR and the LR are very weak and that many institutions manage to hold significant buffers on top of all prudential requirements at the same time.

⁷ See EBA report on LR of 3 August 2016; <https://www.eba.europa.eu/documents/10180/1360107/EBA-Op-2016-13+%28Leverage+ratio+report%29.pdf>

7. **Impact of BCBS work on reducing excessive variability in risk weighted assets (RWA).** Concerns were also raised on the upcoming calibration of the revisions at the BCBS level to tackle the excessive variability in risk-weighted assets, through the use of floors, amendments to the approaches for credit and operational risk and the Fundamental Review of the Trading Book (FRTB). Concerns were raised that these measures would significantly increase capital requirements, which would be reinforced by a similar complementary increase in TLAC requirements. These increased capital and bail-in requirements could have an unwarranted effect on funding costs and loan supply by banks. These concerns should be considered against the background of the Group of Central Bank Governors and Heads of Supervision (GHOS) statement that the BCBS will focus on not significantly increasing overall capital requirements. That ambition is shared by the Commission and Member States alike, as highlighted by the ECOFIN conclusions of July 2016.

Some of the concerns raised have, where appropriate, fed into the preparation of the CRR2 package⁸, which contains targeted measures to reflect the warranted concerns that have been raised in the call for evidence.

Whilst it is true that for banks with overall low risk weights, the LR may indeed become the most constraining capital requirement measure, the LR is a non-risk sensitive measure. As stated by the EBA, the LR and the risk-based capital requirements should function in a complementary manner, with the LR defining a minimum backstop of capital to total exposure requirement through the cycle and the capital ratios allocating capital on a risk sensitive basis. Exempting certain exposures (based on risk sensitivity) from the LR or reducing the calibration of the LR for certain business models might reduce the effectiveness of the LR as a backstop measure. Nevertheless, there are cases where some adjustments are warranted, such as public development banks' lending to the public sector and pass-through promotional loans. These banks are subject to legal constraints on their business models and thus have less discretion to manage their balance sheet or income compared to universal banks that can freely choose their business model. In those cases, the LR ratio as proposed by the BCBS may have an undesirable adverse impact on the access to finance. As a result, in the CRR2 package, the Commission proposes to exclude from the LR exposure measure: public development loans and pass-through promotional loans provided by public development banks set up by a Member State, central or regional government or municipality.

⁸ The "CRR2 package" describes the combination of risk reduction measures in the following proposals: "Proposal for a Regulation of the European Parliament and the Council amending Regulation (EU) No 575/2013 and Regulation (EU) No 648/2012", "Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU", "Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU" and "Proposal for a Regulation of the European Parliament and the Council amending Regulation (EU) No 806/2014".

Second, as well-functioning repo markets are important for both market-making on the underlying collateral and liquidity management of banks, a recalibration of the stable funding requirements for short-term transactions with financial institutions compared to the Basel NSFR treatment has been proposed, subject to a review clause.

Third, the Basel treatment of derivatives under the NSFR, in particular the 20% RSF factor that applies to gross derivatives liabilities and the treatment of variation margins received, has been amended in the CRR2 package proposal in order not to hinder the functioning of EU financial markets and the provision of risk hedging tools to credit institutions and end-users.

Fourth, as regards the LR, the BCBS agreed that initial margin cannot offset the potential future exposure of derivative exposures that a bank centrally clears on a client's behalf. The CRR2 package proposal will allow the deduction of these initial margins so as not to undermine the provision of central clearing services by institutions to clients.

Finally, as regards trade finance, the EBA recommends a specific treatment in the NSFR, as these short-term transactions are less likely to be rolled-over than other types of loan to non-financial counterparties. As regards the LR, short term trade finance exposures, such as letters of credit, are often subject to higher capital charges under the risk-based framework, so the LR would not be constraining compared to the risk-weighted capital requirements. However, this is different for export credits guaranteed by sovereigns or export credit agencies which receive a considerably lower risk weight. In such instances, the leverage ratio would be a constraining capital requirement, leading to higher capital charges. Given these considerations, the Basel NSFR has been slightly amended in the CRR2 proposal to incorporate a specific treatment for trade finance activities, whilst export credits guaranteed by sovereigns or export credit agencies will be excluded from the proposed LR.

B) Pillar 2 requirements

Bank capital requirements stem from three distinct categories:

- (1) "Minimum" requirements applicable to all banks (so-called Pillar 1 capital requirements);
- (2) Additional capital requirements imposed on individual institutions by supervisors for risks not covered or not sufficiently covered by Pillar 1 (so-called Pillar 2 capital requirements); and
- (3) The combination of various buffer requirements related to certain risks applicable to all institutions or a subset of institutions (so-called combined buffer requirement).

Responses to the call for evidence as well as responses to the public consultation on the CRR/CRD IV and results of the EBA's monitoring of existing supervisory practices highlight that Pillar 2 capital requirements are an important determinant of an institution's overall level of capital. Competent authorities adopt different approaches to determining and applying Pillar 2 capital requirements, which raise concern both in terms of legal certainty for investors and level-playing field.

Respondents also voiced concerns about the relation between Pillar 1, Pillar 2 and buffer capital requirements (so called "stacking order" of capital requirements) and the impact they may have on the automatic restrictions on earnings distribution, foreseen when buffer capital requirements are breached.⁹

Moreover, it is argued that the current CRD and CRR rules allow for different interpretations of how Pillar 2 capital requirements may be imposed and their relationship with Pillar 1 and buffer requirements. This may result in different amounts of (Pillar 2) capital imposed on individual banks across Member States, which have an impact on the Maximum Distributable Amount (MDA) trigger. In addition, banks are not obliged to publicly disclose the level of Pillar 2 capital requirements, although they can be invited by supervisors to do so. If not disclosed, investors including those in Additional Tier 1 (AT1) instruments cannot predict when the restriction on distributions may be triggered (MDA restrictions).

An institution will typically hold more capital than required to ensure that there is adequate margin to avoid any breach of the combined buffer. If, however, the competent authority suspects that an institution may not be able to meet its capital requirements at all times, it may provide Pillar 2 'capital guidance' to the institution. Respondents argued that the nature of such guidance should be clearer. As 'capital guidance' is not a formal requirement, automatic and immediate consequences in terms of restrictions on earnings would not apply for institutions operating below the guidance level, but still above the combined buffer capital requirement. Finally, respondents also argued that it may be appropriate to consider a more effective use of the combined buffer requirement in practice.

In the CRR2 package, the Commission proposes to disclose additional Pillar 2 capital requirements imposed by supervisors and clarifies some aspects of Pillar 2 capital requirements, including the "stacking order", by:

(i) distinguishing more clearly between Pillar 1 (applicable to all banks) and Pillar 2 (bank specific) capital requirements;

⁹ According to the CRD, an institution is subject to automatic restrictions on earnings distribution when its total capital falls below the sum of Pillar 1 capital requirements, Pillar 2 capital requirements and the combined buffer capital requirements.

(ii) clarifying the difference between Pillar 2 capital requirements (to be met by the bank at all times and subject to public disclosure) and Pillar 2 capital guidance (which implies an expectation that the institution has additional capital beyond mandatory capital requirements);

(iii) clarifying that the MDA shall be calculated by taking into account Pillar 1, Pillar 2 and buffer capital requirements (but not the Pillar 2 capital guidance) and that the AT1 instruments should be given priority if, as a result of the MDA calculation, distributions have to be limited.

C) Adjusting prudential rules in light of the Banking Union

Respondents argued that the level of application of prudential requirements and the exercise of supervisory options should be adapted in light of the Banking Union. Bank prudential requirements apply at both consolidated (group) level and at the level of individual subsidiaries. However, they can be waived in certain instances. For example, the application of capital requirements to a subsidiary can be waived, if located in the same Member State as the parent institution. Moreover, since January 2015, the application of liquidity requirements at individual level can be waived for institutions authorised in several Member States under certain conditions.

Some respondents argue that the conditions governing these waivers are too strict and fragment capital and liquidity in the single market. Some claim that the possibility to establish cross-border liquidity sub-groups and waive individual liquidity requirements so far has been of limited practical effect. They therefore argue that the waivers, as well as the exercise of supervisory options, should be adapted in light of the Banking Union, so that the euro-area is considered as one jurisdiction.

The financial crisis has led many banks to reduce cross-border activities and refocus on home markets and core activities. In some instances, this fragmentation may have been amplified by national supervisors' attempt to ring-fencing capital, liquidity and funding to protect national depositors and ensure continuity of national activity. However, the establishment of the Banking Union might warrant a review of the conditions governing the waiver of the application of prudential requirements at an individual level for entities that are supervised at a consolidated level across the banking union. In fact, those entities are also subject to the Single Resolution Mechanism (SRM), which provides for a common system and centralised decision-making for resolving banks and paying for resolution. There is accordingly a degree of pooled resources for managing the fiscal consequences of bank failures, as well as harmonised rules and supervision. In light of progress made on the Banking Union, the Commission is proposing in the CRR2 package measures that have the potential to foster the integration of cross border banking in the Banking Union area, subject to appropriate safeguards. This could potentially improve the ability of cross-border banks to manage capital and liquidity within the group, reduce fragmentation and enhance banks' capacity to finance the economy.

D) BRRD bail-in recognition language (Art. 55)

Respondents have raised practical concerns with Article 55 of the Directive 2014/59/EU establishing a framework for the recovery and resolution (BRRD). The BRRD requires banks to include a clause in their contracts with third country counterparties governed by the law of a third country, by which the creditor recognises the bail-in power of EU-resolution authorities. This obligation is particularly relevant for branches of EU banks in third countries, as their business is usually governed by contracts under local law.

Respondents argued that banks encounter two types of difficulties when seeking to comply with Article 55 BRRD. First, certain non-EU counterparties refuse to include a contractual clause recognising an EU bail-in power, applying their own or standard internationally agreed contractual terms in their banking contracts, e.g. liabilities to non-EU financial market infrastructures, trade finance liabilities (letters of credit, bank guarantees and performance bonds). As banks often lack the means to force their counterparties to accept these clauses, the only way to comply with Article 55 would be not to enter into a contract at all. Second, even if non-EU counterparties are prepared to accept such clauses in their contracts with EU-banks, in some cases the local supervisor may not allow it. Another related issue is the wide scope of Article 55 applying to all liabilities but those excluded from bail-in and eligible deposits. The consequence is that, in some cases, it would practically prevent banks from operating in third countries. In order to comply, banks would either have to adopt costly structural measures, such as converting their branches in third countries into subsidiaries, or completely discontinue certain business activities.

To achieve a credible resolution regime, there must be reassurance that global institutions can be resolved in an orderly manner without causing disruptions to the financial system and to the economy in general. This is only possible if institutions hold sufficient liabilities that can actually be bailed-in in resolution. In this spirit, the EU agreed initially on a broadly worded provision (Article 55 of BRRD), whereby any liability, which is subject to the law of a third country would not escape the normal loss absorption cascade in resolution, and therefore, would not be treated more favourably than other liabilities of the same type only for the reason that they are not subject to EU law. Yet, this should not be seen as a one-size-fits-all approach. A series of instruments, including trade finance, are of the utmost importance for international trade, in particular, for small and medium sized EU companies. In this regard, Article 55 should not worsen access of European manufacturers and service providers to trade finance instruments, which would weaken their competitiveness in international markets with potential adverse economic effects in the EU.

In order to quantify the possible issues, the Commission services gathered further evidence and carried out an analysis. The conclusions are that the issue on subordinated and senior debt governed by non EU law is generally sizable for parts of the industry, but there are large divergences across individual firms. For contingent liabilities arising

from e.g. trade finance products (e.g. letters of credit), liabilities vis-a-vis Financial Market Infrastructures/Central Counterparties (FMIs/Central counterparty clearing houses "CCPs") and derivatives contracts, it may be that the costs outweigh the benefits of imposing this contractual recognition.

The Commission therefore proposes to amend Article 55 of the BRRD to ensure that resolution authorities can apply the requirement for contractual recognition of bail-in provisions for non-EU creditors in a pragmatic manner. The authority can exclude the obligation by means of a waiver, if it determines that this would not impede the resolvability of the bank and that it is legally, contractually or economically impracticable for banks to include the bail-in recognition clause for certain liabilities. In these cases, those liabilities should not count as MREL and should rank senior to MREL to minimize the risk of breaching the No-Creditor-Worse-Off (NCWO) principle.

2.2. SME financing

Small and Medium-sized Enterprises (SMEs) are the backbone of the EU economy and the main source of employment and growth. They largely rely on bank credit to finance their activities (in particular, short-term credit lines and leasing). To date, other sources of financing, such as equity and debt capital markets, are not widely available but mainly limited to large companies and/or companies in countries with larger capital markets.

A) Bank lending

As regards bank lending to SMEs, respondents advocated continuation of the current supporting factor (SF) for loans to SMEs and extension of capital relief to banks' investments in bonds and equities issued by SMEs. The European Parliament also called on the Commission to examine the possibility of recalibrating the supporting factor, including size and threshold, and to examine possible interactions with other regulatory requirements, in a Resolution on Access to finance for SMEs which was adopted on 15 September 2016.¹⁰

Under the Basel rules, SME loans are subject to lower capital requirements than loans to large enterprises, either because they can be classified as retail exposures or due to their reduced size when they are allocated to corporate exposure. When classified as retail exposures, SME loans attract a flat risk-weight of 75% under the Standardized Approach (SA) and a reduced correlation coefficient under the Internal Ratings Based (IRB) Approach. When classified as corporate exposures under the IRB Approach, SME exposures nevertheless receive a lower capital requirement on the basis of a factor which depends on their size.

¹⁰ Resolution on Access to finance for SMEs and increasing the diversity of SME funding in a Capital Markets Union, (2016/2032(INI)).

Moreover, in order to avoid abruption of bank lending to SMEs in light of the overall increase in the minimum required capital requirements for banks the CRR introduced a SF on these Basel rules resulting in a capital reduction of 24% for SME loans below EUR 1.5 million.

Currently, bank loans below EUR 1,5 million to SMEs receive a reduction in capital requirements compared to loans to larger enterprises. In the CRR2 package, the Commission is proposing to extend the 'SME supporting factor' to all SME loans, including those larger than EUR 1,5 million on the basis of evidence obtained on the actual riskiness of SME loans over the whole economic cycle, while ensuring that minimum capital requirements remain consistent with the riskiness of SME loans.

B) Market financing

Respondents broadly supported the reforms to capital market regulation. They however expressed concerns about how the market abuse, prospectus and securities market legislation affects market financing of SMEs.

Market abuse regime and SME growth markets. Some respondents argued that the market abuse regime places a high burden on issuers in SME growth markets, which may ultimately result in less activity and thus reduced financing for SMEs. Particular concerns relate to the widening of scope of issuers' duties under the Market Abuse Directive and Market Abuse Regulation (MAD/R)¹¹ regime to companies listed on Multilateral Trading Facilities (MTFs), such as providing insider lists and notifying managers' transactions.

Several elements should be taken into consideration when assessing stakeholders' concerns: (i) under certain conditions, SME growth market issuers are already exempted from certain requirements, like the special regime for drawing up an insider list, and (ii) as per experience of the competent supervisory authorities across the EU, the majority of cases of market abuse involve issuers of a smaller size. The Commission services therefore consider that the alleviated burden for SME growth market issuers has been carefully set to strike the balance between encouraging SMEs to join these trading venues and protecting investors. The Commission services will closely monitor market developments to ensure that the balance holds in practice once the SME growth markets are operational.

¹¹ Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive) and Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

Prospectus Directive¹². Stakeholders argued that the prospectus requirements for issuers are too burdensome and raise the cost of access to capital markets, in particular for smaller companies.

In November 2015, the Commission issued a proposal to revamp the Prospectus Directive, which is under negotiation.

MiFID inducement rules and investment research in SMEs.

Trade execution services and investment research are frequently sold as a bundle to portfolio managers, whereby the research is generally offered as a secondary feature to make the offering of the trade execution service more attractive. In the Commission Delegated Directive research can be paid for in one of two ways: (1) out of manager's own resources or (2) from a research payment account, separately and unbundled from commissions for the trade execution service. Other operational arrangements for the collection of the client research charge, whereby payment for research is collected alongside a transaction commission, will be allowed if the arrangements comply with specific conditions. Some respondents argued that these rules will impede the provision of research, especially in the area of SMEs. Furthermore, it was claimed that the price of SME research would increase, as it would have to be budgeted independently.

As part of the broader work on SME financing and listing, the Commission will assess the implementation of the rules under the Markets in Financial Instruments Directive (MiFID II) on investment research in relation to SMEs. While the changes overall are expected to reduce conflicts of interest and improve the functioning of the market, the effect of the rules on the provision of SME research needs to be monitored closely.

C) Prudential treatment of leases

Some stakeholders raised concerns on the new International Financial Reporting Standards 16 (IFRS)¹³ on lease accounting issued by the IASB in January 2016, which is currently in the endorsement process in the EU. The standard introduces a new asset category, i.e. the right to use a leased asset. It does not however explicitly specify whether such rights are tangible or intangible assets in the financial statements. This lack of clarity is viewed as problematic by some respondents because prudential rules require different levels of capital for different asset categories, with intangible assets to be

¹² COM(2015) 583 final.

¹³ Commission Regulation (EU) 2015/2113 of 23 November 2015 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Accounting Standards 16 and 41

deducted fully from the highest quality of regulatory capital with a potentially high adverse impact on capital ratios.

The Commission services will invite the EBA to follow this issue, taking into account the views of the Basel Committee.

2.3. Long-term investment

Many respondents argued that regulation may reduce financial institutions' ability to finance long-term investments, in particular infrastructure investments. Most respondents focused on insurance legislation (Solvency II)¹⁴ and bank legislation (CRR/D). However, respondents also highlighted legislation governing certain funds (Regulation on European Long term Investment Funds, ELTIFs)¹⁵, accounting rules and taxation as factors deterring more long-term investments.

A) Solvency II impact on long-term investment

Respondents expressed two concerns on how Solvency II may limit insurance companies' ability to finance long-term investments: volatility of valuation and high capital charges. As regards volatility, respondents argued that the market-based valuation of the one-year risk measure framework for assets and liabilities can create significant balance-sheet volatility, when the asset/liability management is not fully reflected in the valuation approach. This volatility increases during periods of market stress, especially for long-term debt, because capital requirements increase with duration. Insurers will have to hold capital buffers to cope with both balance sheet volatility and solvency capital requirements. Respondents argued that this can incentivise insurers to exhibit pro-cyclical behaviour by too quickly disposing of these long-term assets in a bearish market environment. While the respondents acknowledged that the co-legislators have agreed on the long-term guarantees measures package that partly mitigates volatility, they argued for relaxing the conditions for its application. For example, the conditions for this matching adjustment might be too limiting and they only partially mitigate market movements (by not mitigating default spreads).

Furthermore, respondents argued that capital charges on specific assets are above the actual risks that these assets create for insurers. Respondents argued that their long-term

¹⁴ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

¹⁵ Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds

investment perspective should be better reflected in the methodology for calibrating capital requirements. The issue is particularly important for illiquid assets such as infrastructure, private placements and SME loans, which have no market price. Finally, respondents also called for a review of risk calibrations for other asset classes (Commercial mortgage-backed securities "CMBS", real estate, strategic equity participations, private equity, securitisation, etc.).

In the Solvency II framework, the long-term guarantees package provides for a set of measures that mitigate artificial balance sheet volatility. The conditions for the application of these measures are designed to preserve an adequate level of risk-sensitivity. The legislators have scheduled a review of the long-term guarantees package, and the European Insurance and Occupational Pensions Authority (EIOPA) is tasked to deliver annual reports on the impact of the framework. The Commission services will carefully follow any indications on excessive volatility and pro-cyclical behaviour, with a view to alleviate these issues where appropriate.

The Commission will also assess the prudential treatment of private equity and privately placed debt in Solvency II to evaluate if this constitutes an impediment to investments. Action as regards the calibration of simple, transparent and standardised securitisation will depend on the timing of co-legislators' agreement on a framework for simple, transparent and standardised securitisation.

B) Infrastructure investments

Encouraging investments in infrastructure, in particular from insurance companies and banks, is part of the Investment Plan for Europe's to stimulate investments and growth in the European Union. A targeted, risk-sensitive treatment of long-term infrastructure investments subject to prudential criteria under Solvency II and CRR can play an important role.

As part of the CMU Action Plan launched on 30 September 2015, and based on expert advice from EIOPA, the Commission lowered risk charges for 'qualifying infrastructure projects'. The risk calibration for investment in unlisted equity shares of such projects has been reduced from 49% to 30%. Risk charges for investments in infrastructure debt were also reduced by up to 40%, depending on the credit worthiness. Whereas these changes were welcomed, some stakeholders nevertheless called for an extension of this new measure to infrastructure corporates.

As regards the banking sector, some stakeholders raised concerns about the more severe prudential treatment of specialised lending envisaged by the Basel Committee in its consultation paper of December 2015 on the revision of the standardised approach. According to these submissions, the consultation paper wrongly assumes that, when compared to corporate lending, specialised lending is a riskier activity. Respondents argued that historical data and recovery rates show that this is not the case. These stakeholders asked for the introduction in the standardised approach of a more risk-

sensitive treatment compared to the current one (specialised lending exposures are treated as corporate loans).

As regards insurance, assessment is under way on how to revise the capital charges for infrastructure corporates. The Commission services are currently assessing EIOPA's advice, delivered in June 2016, with a view to adopting a further amendment to Solvency II in 2017 to reduce capital charges for investments in infrastructure corporates.

Similarly, in the CRR2 package, the Commission proposes to lower credit risk capital requirements for banks' investments in infrastructure which fulfil a set of criteria able to reduce significantly their risk profile. Capital requirements for credit risk on exposures to entities that operate or finance physical assets that provide or support essential public services would be multiplied by the factor 0.75 provided they comply with the criteria mentioned above.

C) Accounting rules

Stakeholders highlighted the importance of the accounting framework in determining incentives for long-term investment. Specific concerns were raised about the IFRS dealing with the treatment of financial assets (IFRS 9 "financial assets"). This standard is still to be implemented at EU level. As regards the impact on long-term investment, a few stakeholders criticised the ban on the recognition of capital gains and losses in the profit and loss account on the disposal of equity investments. They argued that financial statements will not depict the resulting performance properly, affecting investments in equity. Several respondents addressed the impact of fair value accounting, arguing that it has a potential to exacerbate the effects of economic cycles and increases pro-cyclicality.

Respondents from the insurance industry also argued that it is essential that IFRS appropriately reflect the activities of insurers in their financial statements, including the provision of long-term guarantees and long-term investment. In this regard, they raised particular concerns about the interaction between IFRS 9 "financial assets" and the future insurance contract standards (IFRS 17). The latter is being finalised (expected early 2017, with application date in 2020 or 2021) by the International Accounting Standards Board (IASB) and will have to go through the EU endorsement process before becoming EU law. Insurance representatives argue that there is a need for an option to defer the implementation of IFRS 9, so it can be implemented at the same time as the future IFRS 17. Also, IFRS 17 needs to be finalised in a way that works appropriately with IFRS 9 to avoid adverse effects on insurers' long-term activities.

As regards the impact of IFRS 9 on long-term investment, the Commission services' analysis in the context of the endorsement process of this standard found that significant changes in the investment strategy of insurers are not expected as a result of this accounting change. However, the Commission services will closely monitor its impact in this area to ensure there are no adverse unintended effects on long-term investments. In the area of banking, see section 5.1.C.

As regards the interaction between IFRS9 and the future insurance contracts standard, a solution to the misalignment of the application dates of IFRS 9 and the upcoming insurance standard has recently been finalised by the IASB. The Commission services are currently considering whether the IASB solution is satisfactory for Europe.

D) European venture capital funds (EuVECA)¹⁶ and European social entrepreneurship funds (EuSEF) Regulations¹⁷

The analysis of the responses suggests that there is widespread support for broadening the range of managers permitted to manage and market funds using the "EuVECA" and "EuSEF" labels by including managers authorised under the Alternative Investment Fund Managers Directive (AIFMD)¹⁸.

Stakeholders also expressed mixed views over reducing the minimum investment required to invest in EuVECA and EuSEF funds by non-professional investors (€100,000). Some respondents were in favour of reducing it, thereby broadening the range of potential investors in order to increase choice for non-professional investors. Other respondents considered the risk profile, contractual obligations and illiquid nature of investing in venture capital and social enterprises to not necessarily be suitable for retail investors with less capital. Others noted that additional tailored investor protection rules would be necessary to support this group of investors, the cost of which would not offset potential increases in the investor base.

Moreover, the majority of responses supported an expansion of the range of assets eligible for investment by EuVECA funds, arguing that the definition of qualifying portfolio undertakings is too restrictive. Finally, responses also suggested increasing the limit on employee numbers and removing the turnover and balance sheet limits.

On 14 July the Commission adopted a proposal to revise existing rules on EuVECA and EuSEF funds¹⁹. The proposal would open up the market for these funds to AIFMD-authorized managers, so that they can offer a full range of products to clients from their home and other Member States, which in turn would increase the overall penetration of

¹⁶ Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds.

¹⁷ Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds.

¹⁸ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

¹⁹ COM(2016) 461 final, 14.7.2016.

such funds. The proposal would maintain the entry ticket of €100,000 for the minimum investment in EuVECA and EuSEF funds. It would permit EuVECA investments in undertakings with up to 499 employees (small mid-caps) and in small and medium-sized enterprises listed on a SME growth market as defined in Markets in Financial Instruments Directive (MiFID II)²⁰. It would also permit follow-on investments in a given undertaking that, after the first investment, does not meet the definition of the qualifying portfolio undertaking any more. Moreover, the proposal would decrease costs by explicitly prohibiting fees imposed by competent authorities of host Member States, simplifying registration processes and determining the minimum capital to become manager.

E) Tax barriers to cross-border investment

Stakeholders highlighted burdensome withholding tax procedures as a major barrier to cross-border investment. Double taxation agreements concluded between states should normally allow investors directly or indirectly investing (among others) through investment funds to avoid double taxation, either by getting relief at source or by benefiting from full or partial refund. However, relief or recovery of withholding tax is, in practice, difficult notably because of the complexity of the procedures, which are also costly and require time to reclaim funds. The non-standardised nature of withholding tax procedures may also require the need to hire local entities to reclaim the funds. Investment and pension funds claimed to be particularly impacted by complex withholding tax procedures.

In line with the CMU Action Plan, the Commission services started an exchange of best practices among Member States to make withholding tax procedures more efficient. Work is ongoing with Member States towards agreeing on a code of conduct in 2017 to encourage relief at source when possible and make procedures to reclaim withholding tax more efficient.

2.4. Market liquidity and trading

Some industry responses argued that specific pieces of legislation and their cumulative impact have had a detrimental impact on market liquidity, particularly in corporate bond and repo markets. However, other respondents question whether regulation was the main driver, arguing that other factors play a greater role and that the rules are overall beneficial for stability and growth. All agree on the need to gather more data and deepen the understanding of recent liquidity dynamics.

²⁰ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

Market participants warned that regulation reduces banks' willingness and ability to act as market makers and to transact in repo markets, pointing to the impact of specific (existing and upcoming) rules and the cumulative effect of banking and capital market regulation.

A) Impact of banking rules

As regards the impact of existing banking rules, stakeholders claimed that higher capital requirements under the CRR/CRDIV have made it more capital-intensive for banks to hold inventory of certain securities and trading assets and that the liquidity coverage ratio (LCR) increases banks' demand for high quality liquid assets (HQLA).

However, the main concerns related to upcoming banking rules, where work is ongoing at international level at the BCBS. Some of these overlap with the concerns presented in section 2.1 to banks' ability to finance the economy (e.g. impact of the NSFR). Nevertheless, two specific concerns regarding the impact on market liquidity in particular were also expressed.

Leverage Ratio (LR). Respondents argue that the LR is constraining broker dealers' balance sheets particularly with respect to low margin business, such as repos, and incentivises market-makers to hold fewer inventories on their balance sheets. A preliminary investigation by the European Systemic Risk Board (ESRB)²¹ into the potential impact of a LR requirement on market liquidity, found that aside from any costs due to the potential adjustment actions, the LR is also expected to support market liquidity, particularly during periods of stress because it makes firms better able to absorb shocks. The ESRB also investigated the impact of the LR on inventories, trading assets and repo activity from the date of the BCBS announcement in 2010 until end-2014. The findings suggest that banks that needed to improve their leverage ratios to meet a 3% requirement or market expectation have been doing so in part by reducing the size of their balance sheets. However, neither trading assets nor repos have significantly fallen as a share of these banks' total assets since 2010. Furthermore, the preliminary statistical analysis investigating the relationship between dealers' inventories and their LR showed very little evidence of a significant relationship between the two since the start of the data series in 2014.

Fundamental Review of the Trading Book (FRTB). Under the revised BCBS framework, capital will be calculated for trading activities at a desk level. The framework will also include liquidity horizons for trading risks, requiring more capital for less liquid products. Some stakeholders expressed the concern that the rules might significantly

²¹ See [EBA report on LR](#), Annex 3 - ESRB preliminary investigation into the potential impact of a leverage ratio requirement on market liquidity, August 2016

increase the total risk-based capital requirements. Illiquid markets (e.g. corporate bonds) are likely to be impacted more than liquid ones.

In the CRR2 package the Commission proposes adjustment to the BCBS proposal on the leverage ratio (see section 2.1.A) and the FRTB. As regards the latter, the FRTB will be phased-in so as to avoid potential disruptions of certain banking services, such as market-making, due to a steep and sudden increase in the overall market risk capital requirements of EU banks.

B) Impact of capital market regulation

Short-Selling Regulation (SSR)²². Stakeholders argue that the scope of the exemption for market-making activities for uncovered short sales of shares, sovereign debt securities and sovereign CDS is too narrow. Because of the way market-making activities are defined in the SSR, the exemption can be read as only granted in relation to a financial instrument that is traded on an EU trading venue where the market maker is a member. This would mean that market-making activities on instruments that are not admitted to trading or traded on any trading venue cannot qualify for the exemption since the membership requirement cannot be met. Stakeholders disagree with this interpretation of the notion of "market-making activities" and consider the membership requirement as being excessively restrictive.

MiFID II and Markets in Financial Instruments Regulation²³, **MiFID/R (application from 3/1/2018)**. Market operators and investment firms express concerns that the scope of the pre-trade transparency regime makes it harder to hedge the risk of the position and allows other traders to benefit by taking counter positions in the interdealer market. To compensate for the risk of adverse price movements, the spread may rise (or in some extreme cases dealers may not quote at all).

Central Securities Depositories Regulation, CSDR²⁴ (**applicable 2 years after the entry into force of the relevant technical standards**). The CSDR aims to reduce the number of settlement fails through a range of measures including – as a last resort – a mandatory buy-in (i.e. an obligatory execution of the initial trade within a certain number of days from the date of the trade) and cash penalties on the party that fails to deliver the

²² Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps.

²³ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

²⁴ Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

securities ('settlement discipline' measures). Together, these measures should discourage settlement fails, leading to a more efficient and reliable settlement. Nevertheless, several issues were raised:

- First, dealers claim that the introduction of the mandatory buy-in regime may have a negative impact on market liquidity.
- Second, respondents argued for flexibility in the application of buy-ins, in particular with respect to less liquid assets and assets traded on SME-growth markets.
- Third, it was argued that the buy-in should be undertaken at the trading level rather than at the CSD level.
- Finally, stakeholders argued for sufficient time to prepare for the application of the rules on settlement discipline.

Concerns about the level of liquidity are important, but there is a need to understand better the specific impact of regulation on the market and, importantly, to identify any unintended effects. Under the CMU Action Plan, the Commission services are reviewing the functioning of the corporate bond markets in the EU. To feed into this process, a study has been launched on the drivers of corporate bond market liquidity and an expert group of market experts has been established. Further analysis of repo markets is also warranted, given their central importance for market liquidity and banks' liquidity management. Alongside the comprehensive review of corporate bond markets as part of the CMU Action Plan, the Commission services will also assess the functioning of markets in repurchase agreements.

With regards to the exemption for market-making activities, the Commission services plan to evaluate the definition of the market making activity in the SSR.

Measures supportive of market liquidity have already been introduced in the other areas:

- The revised MiFIR RTS 2 introduced a more cautious pre-trade transparency regime via a phase-in regime for non-equity instruments. This ensures that only the most liquid instruments are covered by the scope of the pre-trade transparency requirements. Specific concerns on the pre-trade transparency requirements for package transactions have also been addressed via an amendment of MiFIR (as part of the amendment relating to the extension of the application date).

- The majority of the concerns raised on CSDR settlement discipline requirements have been taken into account. The CSDR delegated act on cash penalties and the draft RTS on settlement discipline are carefully calibrated by introducing more proportionate rules for less liquid instruments as well as instruments traded on SME growth markets (e.g. lower penalties for settlement fails and longer periods before buy-ins are launched). Moreover, European Securities and Markets Authority's (ESMA) draft RTS provides for the buy-in taking place at the trading level as unanimously requested by industry. Finally, ESMA's draft RTS proposal and the Commission's delegated act on the parameters for the

calculation of cash penalties include a two-year phase-in to provide industry with sufficient time to adapt.

2.5. Access to clearing

Many respondents voiced concerns about possible inconsistencies arising from the interaction of market infrastructure (European Market Infrastructure Regulation, EMIR)²⁵ and predominantly banking legislation (CRR) but also fund management legislation. There are three inter-related strands to these concerns.

A) Ability of banks to provide clearing services

EMIR requires that liquid and standardised OTC derivatives are centrally cleared through an authorised CCP. Access to CCPs is possible through a clearing member, which in most cases is a large dealer bank. Many respondents noted that small financial counterparties with limited derivatives activity often find it difficult to access clearing. The respondents also argued that the leverage ratio would be penalising for banks acting as clearing members, as their exposures (in the numerator of the ratio) do not take into consideration the risk-reducing effect of (segregated) initial margins (see section 2.1). As a result, this may disincentive banks to continue acting as a clearing member or providing client clearing services, possibly leading to further concentration in CCP membership, higher costs and reduced access to client clearing. Another obstacle noted by respondents was the uncertainty as regards segregation and portability options, and their implications for both clearing members and their clients. Respondents pointed out certain challenges in applying these requirements, which might be difficult to implement in certain Member States due to domestic insolvency laws.

The Commission services will consider these points as part of the forthcoming review of EMIR in 2017, in the framework of REFIT, which will be accompanied by an impact assessment which will consider the various issues at stake in more depth. Regarding the LR, the BCBS agreed that initial margin cannot offset the potential future exposure of derivative exposures that a bank centrally clears on a client's behalf. In the CRR2 package, the Commission proposes an adjusted LR to ensure clearing is not unduly penalised (see also section 2.1.A).

B) Margin payments

A related problem is that of access to cash collateral for margining purposes. EMIR requires the exchange of collateral for both centrally and bilaterally cleared derivatives

²⁵ Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories.

transactions. CCPs generally require variation margin to be paid in cash. Pension funds are currently exempt from clearing under EMIR, based on the assumption that they hold little cash and could have difficulties accessing cash collateral in the repo markets in the required volumes. This exemption is set to expire on 16 August 2017, but can be prolonged for an additional year. Once the current clearing exemption expires, pension funds argued that they would be faced with either having to: (i) rely on repo markets for collateral transformation, which may not provide a robust solution in times of market stress; and/or (ii) increase their cash holdings relative to their non-cash asset holdings.

As mentioned in section 2.1, respondents argued that the proposed new CRR measures (LR, NSFR) would discourage banks from providing repo services at a reasonable cost. Moreover, respondents argued that for bilaterally cleared contracts, banks increasingly require pension funds to post variation margin in cash, in anticipation of the forthcoming LR and NSFR, where non-cash variation margin received is not recognised as reducing the exposure. As a result, pension funds argued that they would have to hold significantly higher amounts of cash, which can have a negative impact on their returns and can increase even more the demand for cash on markets.

The prudential measures proposed in the CRR2 package stem from international standards being developed by the Basel Committee. The Basel Committee has just concluded consultations on possible revisions to the Basel III leverage framework, which included questions related to e.g. introducing an adjusted version of the standardised approach on counterparty credit risk (SA-CCR) to determine the exposure value of derivatives under the leverage ratio, instead of the current exposure method (CEM). The BCBS is not considering allowing non-cash variation margins for the calculations of the LR exposure and, as a consequence, for the calculation of the NSFR. Given the importance of the issue, the Commission proposes to allow the recognition of Level 1 HQLA received as variation margins to reduce the derivative exposure for the calculation of the NSFR in the adopted CRR2 package.

Moreover, the Commission services will, in the context of the EMIR Review in 2017 and following-on from the EMIR Report²⁶, assess the relevant technical standards linked to EMIR. Specifically, the Commission services will assess the requirements for pension funds in particular in view of their difficulties in meeting CCP cash collateral requirements (see also "proportionality in derivatives markets", section 3.2). Moreover, the Commission services will consider whether or how corporates and small financials should be captured by clearing and margining requirements.

C) UCITS restrictions focusing on OTC derivatives

²⁶ Adopted by the Commission on the same date as the call for evidence Communication

Respondents argued that the application of several restrictions set out in the Directive on Undertakings for Collective Investment in Transferable Securities (UCITS)²⁷ to centrally cleared OTC derivatives is at odds with EMIR's policy objectives on central clearing. They claim that the statutory counterparty exposure limits (5% or 10%) constrains UCITS' ability to invest in cleared OTC derivatives. Stakeholders questioned whether those diversification limits are still appropriate, given the EMIR central clearing obligation. Furthermore, stakeholders claimed that UCITS cannot use the cash proceeds from a repo transaction to post margins for cleared OTC derivatives transactions. This restriction derives from ESMA's Guidelines on ETFs and other UCITS issues which prohibit any reuse of cash by the UCITS fund.

The Commission services have requested ESMA to analyse the evidence submitted on UCITS restrictions as regards the use of OTC derivatives. Any potential follow-up will be part of the UCITS review.

²⁷ Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.

3. ENHANCING PROPORTIONALITY OF RULES WITHOUT COMPROMISING PRUDENTIAL OBJECTIVES

Proportionality is at the centre of the Commission’s Better Regulation agenda. Regulation must be applied in a proportionate manner to regulated entities, reflecting their business model, size, systemic significance, as well as their complexity and cross-border activity. More proportionate rules will help promote competition and enhance the resilience of the financial system by safeguarding its diversity and dynamism without compromising prudential objectives. Lower entry barriers will allow new players to substitute for services lost when less resilient firms exit the market. At the same time, care must be taken to ensure that measures aimed at enhancing proportionality do not distort the level playing field.

Respondents raised the issue of proportionality of legislation in several areas, including in particular banking (section 3.1), derivative markets (section 3.2), insurance (section 3.3), fund management and credit rating agencies (section 3.4).

3.1. Proportionality in banking rules

The concept of proportionality is clearly recognised in the CRR,²⁸ and differentiation is already reflected in many rules (e.g. exemption on calculating market risk requirements for banks with small trading books). The framework as a whole is formulated in a modular manner, such that institutions must only apply those requirements which are relevant to the risks they incur. Furthermore, the framework provides for specific exemptions and preferential treatments for various purposes (e.g. own funds, liquidity, covered bonds), thus reflecting the relative complexity and riskiness of institutions and the activities they undertake.

Nevertheless, a large number of respondents called for a more proportionate application of banking rules arguing that these do not sufficiently differentiate between the very large systemic institutions and very small local institutions. Some stakeholders, whilst seeing problems in specific requirements, argued against potential changes, as this would require putting in place new systems, thereby imposing additional costs on companies or because it would create an un-level playing field between institutions that compete with each other in the same markets. Respondents questioned the proportionality principle with regards to:

²⁸ Recital 46: “The provisions of this Regulation respect the principle of proportionality, having regard in particular to the diversity in size and scale of operations and to the range of activities of institutions [...] Member States should ensure that the requirements laid down in this Regulation apply in a manner proportionate to the nature, scale and complexity of the risks associated with an institution’s business model and activities”.²⁹ COM(2016) 710 final

- Prudential, reporting and disclosure requirements
- Remuneration
- Investment firms
- Bail-in requirements
- CCPs holding banking licences

A) Prudential, reporting and disclosure requirements

On reporting and disclosure requirements, respondents highlighted the difficulty for smaller and less complex banks to comply with them. There were further concerns that EU reporting requirements were topped-up by supervisors with additional recurrent reporting requirements. Stakeholders argued that banks of less complexity and/or smaller balance sheet size usually pose less of a risk to the economy, and that supervisors should seek to obtain the information they need without enforcing a disproportionate cost on such institutions. They also argued that such banks should be subject to lighter prudential requirements. However, other respondents, while acknowledging the principle of proportionality, argued that the principle needs to be applied with care and that it should relate to bank riskiness (rather than size). They put forward the case that relaxing requirements for some institutions would be more appropriate in relation to only reporting and disclosure requirements as opposed to also including the actual prudential requirements.

In the CRR2 package, the Commission proposes to address concerns related to disproportionate compliance and administrative burden for smaller banks as follows:

- *by mandating EBA to develop tailored reporting requirements involving less frequent and less detailed reporting;*
- *by amending the CRR to provide for differentiated disclosure requirements involving less frequent and less detailed disclosure;*
- *by mandating EBA to develop an IT tool that would help small banks to distinguish the rules which are relevant to their size and activities from those rules which should apply only to larger and more complex banks.*

The Commission also proposes to further tailor prudential requirements in selected areas. This is for example the case for:

- *the trading book (e.g. extension of the de-minimis threshold and keeping the current standardised approach for calculating market risk for certain types of banks);*
- *counterparty credit risk (e.g. keeping the original exposure method for certain types of banks);*

- *the leverage ratio (lower leverage ratio or partial exclusion of the leverage ratio for certain business models or activities such as promotional banks);*
- *the NSFR (e.g. preferential treatment of certain activities such as trade finance, CCPs, promotional loans, etc.).*

Tailored requirements take into account a variety of metrics, which includes size or type of activity.

B) Remuneration

The CRR/CRD contain a number of requirements regarding the remuneration policies and practices of credit institutions and investment firms. These requirements were introduced in the aftermath of the 2008 financial crisis to ensure that remuneration policies do not encourage excessive risk-taking behaviour which was one of the contributing factors to the crisis. Remuneration practices in the financial services industry meant that those incentives were not in line with the long-term objectives of firms and the need for responsible risk-taking. The first remuneration rules, adopted in 2010, were further extended, mainly with the 'maximum ratio rule' between variable and fixed remuneration, following the adoption of CRD IV in 2013 (with the new rules applicable as of 2014).

Numerous responses suggested that a more proportionate approach (i.e. allowing some exemptions) should be reflected in the application of these remuneration rules, especially concerning deferral and pay-out in instruments (applicable since 2011). Arguments have been advanced that these requirements entail compliance costs that tend to outweigh their prudential benefits in case of smaller and non-complex firms or staff with relatively low levels of variable remuneration. Finally, concerns have been raised that the maximum ratio rule would reduce institutions' competitiveness, inter alia by negatively affecting their ability to attract and retain talented staff in comparison with non-regulated firms (either within the financial industry sector or in other sectors to which skills are transferable).

The Commission carried out a consultation on the impact of the maximum remuneration ratio and the overall efficiency of CRD IV remuneration rules: a feedback report was issued in July 2016 summarising the responses. The responses to that consultation and to the call for evidence, together with input from EBA and from an external study, have been taken into account in the Commission's review of the CRD IV remuneration rules, reflected in the Commission report COM(2016) 510 of 28 July 2016. Following-up on the conclusions of this report, the Commission proposes in the CRR2 package to exempt small and non-complex institutions and staff with low levels of variable remuneration from the deferral and pay-out in instruments remuneration requirements. Regarding the maximum ratio, the Commission report found that for the time being there is insufficient evidence to draw final conclusions on the impact of the rule, which has been in force only since 2014.

C) Investment firms

Investment firms argued that the application of some rules under CRR/ CRD IV are disproportionate if they are not tailored to their business models. In particular, it was argued that the CRR/CRDIV should better distinguish between the capital requirements imposed on large, bank-like investment firms and those imposed on smaller investment firms.

As announced in the Commission Work Programme 2017²⁹, the Commission services will carry out an evaluation of the CRR treatment of investment firms, in the framework of REFIT. This exercise will take into account the EBA advice and discussion paper delivered in October 2016³⁰ where it is recommended that only those investment firms that are currently identified as Other Systemically Important Institutions (OSIIs) or Globally Systemically Important Institutions (GSIIIs) remain subject to the full CRR/CRDIV regime while a more proportionate regime could be developed for firms which are not in this category. As an interim proportionality measure, the Commission proposes to "freeze" requirements in the CRR2 package for non systemic investment firms: this will allow the majority of investment firms to remain on the CRD IV rules until the investment firm review is completed, thereby reducing the regulatory burden on these firms.

D) Bail-in requirements

Banks questioned the proportionality of minimum requirements for own funds and eligible liabilities (MREL) under the BRRD, in particular as regards certain bank business models. Often these claims were referring to the total amount of total liabilities minimum MREL requirement included in the draft EBA RTS. Deposit-funded retail and commercial banks that do not rely on wholesale funding claimed they would have to raise additional wholesale funds, which would have to be reinvested. This could mean an artificial expansion of these bank's balance sheet and consequently increase of leverage and deterioration of their risk profile. This could have an influence on the riskiness of assets and profitability. In case the investor base in the local market would be missing, these banks could be forced to raise funding abroad in foreign currencies, which would bring foreign exchange risk. Respondents also raised concerns about inconsistencies between MREL and total loss absorbing capacity (TLAC) measures.

²⁹ COM(2016) 710 final

³⁰ <https://www.eba.europa.eu/-/eba-recommends-that-only-investment-firms-identified-as-gsiis-and-osiis-be-subject-to-the-full-crdiv-crr>

In the delegated act, the EBA RTS has been amended by the Commission to address inconsistencies between the RTS and the BRRD. Residual concerns have been addressed in the TLAC/MREL proposal³¹ which recommends to implement TLAC for G-SIBs only and maintain the case-by-case setting of MREL for other banks. Furthermore, the proposal is also to modify the BRRD in order to promote the technical consistency between the TLAC and the MREL framework.

E) CCPs holding banking licences

A few respondents argued that the BRRD is inappropriately calibrated or applied to CCPs that hold banking licences. Moreover, they argued that the resolution (winding down) of CCPs is already partially covered by EMIR and level 2 texts (via a default waterfall including a default fund and a loss-sharing mechanism) and that standard business relations of financial market infrastructures do not lead to "bailable" liabilities. Finally, it was argued that if deposits placed with such institutions were made subject to potential bail-in, settlement efficiency would decline substantially and participants would rather use pre-financing by the financial market infrastructure.

The Commission proposes to amend the BRRD as to ensure that CCPs with banking licenses currently subject to the BRRD will be carved out from its scope and brought exclusively under that of the proposed CCP Recovery and Resolution Regulation³².

3.2. Proportionality in derivatives markets

Some respondents argued that the impact of EMIR on non-financial corporations (NFCs) is disproportionate. Respondents noted that NFCs face significant challenges in meeting EMIR requirements due to limited resources and experience, especially as regards the reporting requirements. For example, NFCs may be finding the hedging exemption difficult to monitor and apply in practice, which could result in inconsistent regulatory treatment of NFCs across the EU. Many respondents questioned whether such counterparties pose systemic risk to a degree that justifies continued application of EMIR requirements. In addition to NFCs, several respondents suggested that certain small financial counterparties (such as small pension funds, small investment funds, small insurers and small banks) undertake such limited OTC derivatives activity that it is not commercially viable for them to establish clearing solutions.

³¹ Adopted on the same date as the call for evidence Communication

³² Adopted on the same date as the call for evidence Communication

As part of the EMIR review scheduled in 2017 and as set out in the EMIR Report³³, the Commission services will consider adjustments to the scope of EMIR clearing and margin requirements in order to address the diverse challenges faced by NFCs, small financials and pension funds. In particular with respect to pension funds, the EMIR review will consider whether to extend the current temporary exemption from the EMIR clearing obligation or whether to make this exemption permanent.

3.3. Proportionality in insurance

Solvency II replaced 28 national regimes by a single risk based framework. According to Article 29(4) of the Solvency II Directive, the delegated acts and the regulatory and implementing technical standards adopted by the Commission shall take into account the principle of proportionality, thus ensuring the proportionate application of this Directive, in particular in relation to small insurance undertakings. Even though Commission Delegated Regulation (EU) 2015/35 sets out numerous provisions on proportionality, stakeholders complained that the application of the proportionality principle is impaired in practice, resulting in excessive and disproportionate burden on small and medium-sized insurers. However, it was also underlined that, given its recent entry into force, the true impact and application of the principle of proportionality can only be judged once Solvency II has had a chance to “bed down”. For example, under Solvency II, small insurers can benefit from lighter reporting requirements (waivers of quarterly reporting or item-by-item reporting are possible). However, these reliefs are subject to the discretion of the supervisory authorities (and hence vary in different jurisdictions). The implementation of these options is currently being monitored by EIOPA which is expected to report on this by the end of 2016 (see also section 4.1.C).

Stakeholders also underlined in their responses that Solvency II is a highly complex system consisting of numerous provisions which are specified in several regulatory levels (the set of Solvency II rules amounts to over 6,500 pages, most of which are guidelines and supervisory material issued by EIOPA). As a consequence, it was argued that it is very onerous for small and medium-sized insurance companies to keep track of all requirements and their interdependencies. In addition, stakeholders argued that the excessively restrictive guidelines and interpretations of the provisions allowing for proportionate flexibility limit the principles-based approach of the Directive.

Finally, stakeholders also raised concerns about the cost of contracts insurers are obliged to have with credit rating agencies, given that the standard formula calculation contains multiple references to the ratings provided by External Credit Assessment Institutions

³³ Adopted on the same date as the call for evidence Communication.

(ECAI). In specific situations, in particular scenarios involving small and medium undertakings, this information would only be collected for the purposes of reporting, which would carry a non-proportional burden for those undertakings.

The Commission services believe that further work should be done to ensure that all requirements are proportionate to risks. As a first step, on 18 July 2016 the Commission issued a call for advice to EIOPA on the review of 17 specific items in the Solvency II Delegated Regulation. Among other things, EIOPA is tasked to work on simplified methods, assumptions and calculations of certain modules in the standard formula and to further develop the framework for the use of alternative credit assessments. The technical advice will feed into the review of the Solvency II Delegated Act where these issues are intended to be addressed.

3.4. Proportionality in other sectors

A) Asset management

Many asset managers raised concerns about the proportionality and compatibility of different remuneration requirements across legislation. Many management companies offer services and products that fall within the scope of different pieces of legislation, in particular the UCITS Directive, AIFMD and MiFID. As a result, they are legally required to comply with three different sets of rules with regard to remuneration of their personnel. Stakeholders claimed that applying all these rules within one employment contract is barely possible.

In addition to the submissions on remuneration, many industry respondents argued that the scope of the AIFMD is too broad. The definition of “alternative investment fund” currently captures essentially all collective investment vehicles which are not authorised as a UCITS. Stakeholders suggested that the rules should take into account the differences between the various collective investment schemes in order to preserve the diversity of financial products offered.

ESMA has already issued guidelines on remuneration policies under the UCITS and AIFM Directive. Building on the approach set out in the CRR2 package, the Commission will assess the proportionality of rules in the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investment in Transferable Securities Directive (UCITS), for example in relation to aligning remuneration regimes and reducing reporting burdens.

B) Credit rating agencies (CRAs)

In addition to concerns about the lack of competition in the credit rating market (see also section 4.4.A), respondents also argued that the implementation of the EU regulatory

framework for credit rating agencies leads to a disproportionate cost for smaller CRAs while larger CRAs seem to be able to more easily absorb the incremental expenditures. They also claimed that the limits for exemptions are set too low as CRAs with more than 50 employees have to cope with all the requirements of the CRA Regulation. Even though they welcome the CRA III Regulation³⁴ as a significant step to rebuild market confidence in the quality of rating agency work, in their view the multiple layers of compliance and governance costs primarily hinder smaller CRAs from developing their business in Europe without offering tangible benefits from the mandatory registration regime. On this basis, respondents called for a more proportionate approach to the implementation of the rules. Respondents also suggested that the same governance structure should not be required in each office, but certain governance functions could serve across legal entities in Europe.

Based on its mandate in the CRA Regulation, the Commission adopted a report in October 2016 on the state of the CRA market. The report confirmed that overall a balance has to be found between the proportionality of the standards that should apply to smaller CRAs and the necessity to ensure the quality and transparency of the ratings they produce. Hence the Commission will continue to monitor the application of the CRA Regulation on smaller CRAs, in particular the issue of proportionality. This includes simplifying reporting requirements in order to reduce compliance costs or clarifying certain existing exemptions for companies up to a certain threshold in terms of turnover or number of employees and other proportionality measures.

³⁴ Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies.

4. REDUCING UNDUE REGULATORY BURDEN

The regulatory reforms have introduced a large number of new, sometimes complex rules in order to make the financial sector stronger and more resilient. This has posed additional administrative burdens and costs on firms. While sound regulation of the financial sector is necessary to achieve the policy objectives of preserving market integrity and ensuring financial stability, it is important to make sure that the regulatory burden is commensurate with the intended objectives. In line with the Commission's Better Regulation approach, there is a case for assessing and designing rules in such a way that they achieve their objectives at the lowest possible cost, not just for financial services providers but ultimately for the end-users of financial services.

In particular, stakeholders argued for a need to further streamline, to the extent possible, the existing supervisory reporting and public disclosure requirements which are often perceived as being inconsistent and/or duplicative across legislation, excessively complex and not always fit for purpose (see sections 4.1 and 4.2). On top of specific sectorial follow-up actions, there is also a need for a more comprehensive Fitness check of reporting requirements. This is the reason why a project on Financial Data Standardisation (FDS) was launched in order to assess the potential to report financial data more efficiently (at lower cost) and produce better data for risk assessment by the supervision authorities (more details can be found in the dedicated box at the end of section 4.1).

Beyond reporting and disclosure requirements, the scale and pace of regulatory change in recent years have been a key source of compliance costs. The complexity of EU rules, the interaction between various layers of regulation, the inconsistencies of certain rules and the poorly aligned, tight timelines for implementation are seen as challenging in terms of compliance burden on regulated firms. Significant compliance costs also result from divergent transposition of EU Directives into national legislation and from inconsistent enforcement of EU rules. Moreover, many respondents pointed to national rules or supervisory practices “gold-plating” EU rules, thus leading to additional and/or overlapping requirements which are seen as unduly burdensome and can create barriers to the cross-border activity of financial firms (see section 4.3).

Finally, it is important to make sure that regulation does not create any undue barriers to entry in national markets and across borders. There is a need to ensure that EU law is correctly implemented and enforced in all Member States, that national rules do not create unnecessary burdens or obstacles to the provisions of financial services within the single market, and that there is international coordination to avoid an un-level playing field in global markets (see section 4.4).

4.1 Supervisory reporting requirements

A) General issues

The reforms introduced new and/or more stringent supervisory reporting requirements with the aim of ensuring better financial supervision at both micro and macro level. Supervisory reporting should allow supervisors to monitor the safety and soundness of financial institutions as well as the safety of the financial system as a whole, to ensure compliance with investor/consumer protection rules and to detect abuses that undermine market integrity.

Although the rationale of the reporting requirements set out in EU law is valid, respondents from the financial industry pointed to a number of inconsistencies and duplications, and to some unduly burdensome requirements. In some cases, overlaps and/or divergences in the data to be reported to supervisors can be explained by the different objectives of such reporting (e.g. MiFIR reporting is aimed at enabling national competent authorities (NCAs) to monitor market abuse, while EMIR reporting aims at introducing greater transparency into the OTC derivatives markets for regulators to monitor and for market participants to see market trends).

However, notwithstanding the different policy objectives, there are instances where requirements can be streamlined or adjusted. In particular, there is scope for further standardising reporting and reducing the administrative burden. This should go hand in hand with increasing the quality of data provided to supervisors and disclosed to the public as well as maintaining high standards of consumer protection rules.

Such changes do not necessarily imply a major overhaul of existing reporting requirements. At least in the short term, such changes would risk further increasing compliance costs instead of reducing them. Although the new reporting requirements have generated additional compliance costs for firms, these are often one-off costs that the industry has already incurred, and any adjustments would trigger new costs.³⁵

A general concern is the lack of sufficiently aligned formats, standardised templates, and common IT solutions, which may result in excessive complexity and errors. The lack of a central data collection point for the varying reporting requirements was also raised as a source of unnecessary complexity, for example in the case of AIFMD.

Stakeholders argue that the lack of coordination among NCAs, and between NCAs and the European Central Bank (ECB), generates inconsistent and burdensome requirements (e.g. the additional liquidity monitoring metrics where the SSM requested data, while the

³⁵ Respondents have indeed raised concerns about the costs of such possible changes triggering further investment in IT systems.

EBA was still consulting NCAs). Furthermore, banks argue that the Commission implementing regulation on supervisory reporting requires banks to report financial information ("FINREP") which overlaps with other national reporting requirements.

A mapping of those national requirements which go beyond those imposed at EU level could be useful and prepare a discussion with Member States of possible ways to address the identified issues. Also, monitoring national supervisory practices, in cooperation with the European Supervisory Authorities (ESAs), could be useful in order to identify the additional reporting requirements imposed in practice by supervisors on top of EU law, including those which may not be justified.

In the banking sector, respondents are also concerned about the immediate impact of the new European Reporting Framework which is being developed by the ECB/SSM. However, they admit that it will be advantageous once completed, since its ultimate goal is for data to be collected once and for duplicative requirements to be avoided.

The Commission will undertake a comprehensive review of reporting requirements in the financial sector, in the framework of REFIT. Moreover the financial data standardisation project (see the dedicated box at the end of section 4.1), supported by the ISA2 programme, aims to develop a common language on financial data that will address the compliance burden at source and prepare the ground for a 'once for all' approach to reporting.

With regards to requirements stemming from national laws and supervisory practices:

- The Commission assesses systematically the correct implementation of all financial services Directives and where relevant also of Regulations. If it identifies national reporting requirements gold-plating EU rules which are incompatible with EU law, it will challenge them via infringement proceedings if the problem is not resolved swiftly.

- Besides the assessment of national transposition measures in terms of compliance with EU law, a process for mapping national requirements that go beyond those imposed at EU level could be envisaged over time, in view of discussing with Member States possible ways to address the issues identified and sharing best practices, including through potentially more common IT solutions. This could be done in the existing Expert Group on barriers to the free movement of capital³⁶ or in other specialised expert groups.

Moreover, the Commission services will examine the case for establishing central data collection points. Specifically in relation to concerns raised regarding the AIFMD, the Commission services will consider with ESMA the stakeholder proposal to establish a

³⁶ http://ec.europa.eu/finance/capital/expert-group/index_en.htm

central data collection point within ESMA for the varying reporting requirements under the AIFMD, which could help ensure the use of a single format with corresponding data requirements and relieve the necessity for NCAs to collect this data and pass it on to ESMA.

B) Duplicative and/or inconsistent reporting requirements

Stakeholders provided some examples of requirements set out in EU legislation that are perceived as duplicative and/or inconsistent across pieces of legislation:

- EMIR, MiFIR, Securities Financing Transactions Regulation (SFTR)³⁷, Regulation on wholesale energy market integrity and transparency (REMIT)³⁸, UCITS and AIFMD require some data to be reported that is similar but with differences in terms of reporting details, reporting channels, data repositories' requirements and processes, and applicable IT standards. Overlaps are in part due to the different objectives of each set of reporting.
- MiFIR and SSR have different reporting requirements for short sales due to different regulatory objectives. On the one hand, the SSR establishes an obligation to report net short positions on shares and sovereign debt securities to the NCA and/or to the public above certain thresholds. This is to ensure transparency over large aggregated short positions. The objective is to enable regulators (and the market) to monitor systemic risk that an excess of the short selling activity may entail and take action where needed. The obligation lies with the investor and relates to aggregated positions at the close of business. Positions held by market makers are, however, exempt from this reporting requirement. In contrast, Article 26 of MiFIR on the transaction reporting requirement applies – without exception - to all transactions in financial instruments admitted to trading or traded on a trading venue. The MiFIR transaction reporting requirements also apply to all individual transactions and not to the aggregated positions, such as under SSR. It places the reporting obligation on the investment firm executing the transaction, not on the final investor, and there is no exemption for transactions for the market making activities. The MiFIR reporting regime is essentially intended as a monitoring tool to identify market abuse and manipulations that may be sanctioned under MAR.

³⁷ Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

³⁸ Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency

- Solvency II and EMIR require insurers to report to both trade repositories and supervisors. Different definitions and reporting deadlines are set out in Solvency II, EMIR, MiFID, MAR (e.g. under EMIR insurers report the "effective date" of a derivative whereas under Solvency II they report the "initial date", which is defined differently). Whilst each reporting requirement has been designed for a somewhat different purpose, the potential for making the reporting more cost efficient and more effective in terms of meeting its objectives will be investigated.
- The fragmented reporting of net short positions as well as temporary restrictions on short-selling across Member States under SSR was also raised as a concern, with some stakeholders calling for a single reporting platform.

With regards to EMIR, the Commission has adopted in October 2016 a RTS on the minimum details of the data to be reported to trade repositories and a ITS with regards to the format and frequency of trade reports to trade repositories. Both are currently under the scrutiny period in the EP and Council. Moreover work is on-going with regards to the data be published and made available by trade repositories and operational standards for aggregating, comparing and accessing the data.

Finally, with regards to SSR, the Commission services will assess the possibility of introducing a single reporting platform on short-selling to strengthen the information provided to regulators and examine ways to reduce burdens on the reporting of net short positions.

C) Disproportionate and/or excessive reporting requirements

According to respondents, some reporting requirements are disproportionate or excessive/difficult to meet, for example:

- Under Solvency II, insurers have to submit highly granular annual and quarterly information on their risk situation, which may not be necessary for small companies with a simple risk profile. As noted in section 3.3, small insurers can benefit from lighter reporting requirements (waivers of quarterly reporting or item-by-item reporting are possible). It is also argued that the “look-through approach” for reporting investment in funds creates excessive burden for insurers. However, the look-through approach is already applied to a minimal extent to get information necessary for risk management. Only the asset category, the country of issue and the currency of the underlying assets must be reported (no line by line reporting of underlying assets is requested). Quarterly reporting is mandatory only where funds represent more than 30% of total investments.
- It is seen as difficult for smaller and less complex banks to comply with reporting requirements imposed by the Implementing Acts adopted under the CRR, in

particular because of the content and frequency of the reporting. Such reporting requirements may need to be reviewed to ensure proportionate reporting for smaller and less complex banks.

- Dual-sided reporting to trade repositories under EMIR is seen as unnecessarily burdensome, especially for NFCs and small/non-systemic financial counterparties.
- MiFID best execution reporting requirements mandate trading venues and systemic internalisers to publish large volumes of execution information, which are seen as too complex and technical to provide added value for investors.
- MiFID position reporting requirements are perceived as excessive as investment firms are not in a position to control access to information about positions of clients other than the specific trades they directly enter into with their own clients. The reporting regime has not yet entered into application. Once the regime enters into force it will be possible to see which elements are excessive or difficult to comply with. The end-client reporting will have to be monitored in particular.
- The application of the 'double volume cap' mechanism (DVC) set out in MiFID to limit dark pool trading is seen as operationally very complex and to require a large amount of data, which may not be necessary to achieve the objective pursued. The actual impact of these requirements needs to be assessed more in depth.

The Commission will monitor the implementation of Solvency II reporting requirements. Solvency II already provides lighter reporting requirements for small insurers but their implementation is subject to the discretion of the supervisory authorities and hence may vary in different jurisdictions. EIOPA is expected to report on the implementation of these reliefs by end 2016. If the uptake of these proportionality measures is deemed to be insufficient, appropriate follow-up actions could be considered. Moreover, with regards to possible further simplification of the look-through approach in the review of the Solvency II delegated act, a corresponding request for technical advice has been sent to EIOPA on 18 July 2016.

In banking, as part of measures to further enhance the proportionality concept in the CRR (see also section 3.1), the CRR2 package proposes reducing the frequency with which smaller and less complex banks are required to report. Moreover, EBA will publish a set of concrete proposals on how to further reduce the burden stemming from reporting requirements in banking through aligning supervisory, statistical and macro prudential reporting requirements as well as enhancing consistency in definitions used across different pieces of legislation.

With regards to reporting under EMIR, the review planned for 2017 will look at ways to reduce existing reporting requirements for non-financial corporations, small financial corporations and pension funds (see also section 3.2). The objective would be to reduce the compliance burden for market participants while ensuring data quality and making sure that regulators have the right tools to monitor risks and intervene when necessary.

As regards MiFIR reporting requirements, ESMA has to conduct a review by 2020. Possible follow-up actions may be envisaged based on the outcome of the review.

Financial Data Standardisation Project

A project on Financial Data Standardisation (FDS)³⁹ was launched by the Commission services in the first half of 2016 and represents a concrete follow-up action to the call for evidence. It will investigate potential overlaps, duplications and inconsistencies in reporting and disclosure requirements in the regulatory framework and the lack of interoperability in data standards.

The project's vision is that it would be possible to: report financial data more efficiently; monitor more effectively the financial system; produce better data for risk assessment by the supervision authorities; and thus contribute to the safeguarding of the stability of the European Union's financial system.

Based on this vision, the project aims to:

- 1) Examine/identify processes and ways of sharing financial data more efficiently by enhancing the interoperability of (existing) data standards;*
- 2) Identify ways of reducing compliance costs that arise in the context of legal reporting requirements by applying the "once for all" principle in reporting;*
- 3) Explore new solutions to improve the way data can be used by (and shared between) authorities;*
- 4) Identify ways to improve the monitoring of the allocation and evolution of risk in the EU's financial system.*

The information received through the call for evidence is mainly of a qualitative nature and often lacks details. The FDS project therefore aims to provide supporting evidence regarding the perceived overlaps, gaps, inconsistencies and redundancies which will

³⁹ Supported and financed by the Interoperability Solutions for European public Administrations, Businesses and Citizens (ISA²) Programme - http://ec.europa.eu/isa/documents/actions/2016.15_en.pdf

provide a factual and objective basis for possible solutions leading to better regulation and cost reductions.

The project will initially create an overview of the financial data reporting requirements to obtain a high-level understanding of the FDS project scope. Based on this high-level analysis, financial legislation will be selected for detailed analysis.

The detailed analysis will result in: a) an inventory of data reporting requirements which will cover the legal requirements in terms of reporting together with the identification of stakeholders involved, data standards and IT systems used. Based on this overview, areas will be flagged where further standardisation could bring benefits and possible synergies between data reporting requirements will be identified; b) data dictionaries which will identify the different data elements that are part of the legal reporting requirements together with their semantic, metadata, structure, business rules and existing standards. In addition, gaps and inconsistencies will be identified in terms of available standards and absence of data formats/structures for legislative acts.

Finally, a roadmap for interoperable financial data reporting standards will be developed. The roadmap will identify priority areas for financial data standardisation. This roadmap will take into account the need for a general financial data reporting framework and specialised reporting in sectors and must cover the interdependency between sectors and the implementation status of ICT systems used for reporting.

The innovative aspect of the FDS approach is that it will bring together and analyse from several viewpoints the information from different financial sectors (banks, insurance companies, and financial markets). Per sector, information is available but has not been put together. The project will therefore cooperate and exchange information with the relevant stakeholders in the public and private sector and study all areas necessary to achieve the objectives: financial legislation, standardisation, stakeholder requirements, governance, security and data protection, and innovative financial technologies.

4.2. Public disclosure requirements

The reforms have also introduced additional requirements to disclose publicly financial, prudential and non-financial information and data about firms, with the aim of increasing transparency of financial markets. Disclosure requirements should provide investors with any relevant financial and non-financial information about a company that may influence an investment decision. Overall, the rationale of these requirements is not questioned. Yet some disclosure requirements are seen as inconsistent or duplicative. The main examples raised by respondents are the following:

- The two-tier system created by the Transparency Directive (TD)⁴⁰ and the Prospectus Directives require both the publication of financial information of issuers listed on regulated markets in the national officially appointed mechanism (OAM) and the publication of prospectuses on the website of the issuers, the financial intermediary, the regulated market, or the NCA. The Prospectus proposal contains provisions which will address these concerns by requiring the publication of all approved prospectuses on ESMA's website (including a search function).
- The provisions of the TD would be inconsistent with other EU law (e.g. the Prospectus Directive, the Listings Directive⁴¹, MAD, etc.) on various topics, including e.g.: different scope; similar but not identical definitions; parallel, overlapping and redundant reporting requirements. The Prospectus Proposal addresses a very few of this concern and the forthcoming review of the TD in 2018 might be an opportunity to address remaining issues.
- The IFRS and the Accounting Directive (AD)⁴² overlap to a certain extent as regards the content of the financial statements (accounting principles, layouts, notes, etc). The AD prevents in no way the preparation of financial statements in compliance with plain IFRS (EU endorsed IFRS prevail whenever there is a conflict with the AD), but actually requires additional items, such as the audit, the publication, the preparation of a management report, and a few additional disclosure. To further align the AD with the IFRS, especially as regards the elimination of any additional disclosure as suggested, would lower the EU standards, which would lack justification.

⁴⁰ Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC.

⁴¹ Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities.

⁴² Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

- Requirements to disclose non-financial information for certain large companies are perceived by some stakeholders as unduly burdensome, although others claim that more ambitious requirements would be needed.
- Requirements to disclose prudential information are seen to place a disproportionate operational burden on small institutions.
- Some respondents point to the divergent and inconsistent transposition of the Transparency Directive, due to imprecise EU rules (e.g. on the subject of notification of major holdings of voting rights), thus resulting in a very fragmented European landscape for issuers and investors in practice.
- Concerns were expressed about the disclosure requirements in the Deposit Guarantee Schemes Directive (DGSD)⁴³, which requires banks to make available to their clients a standardised disclosure sheet about the protection that applies to their deposits on an annual basis.

The Prospectus proposal (currently under negotiation by the co-legislators) addresses concerns related to duplicative reporting, at least partly, by facilitating the "incorporation by reference" of financial information in the prospectus and by the use of the registration document to fulfil some publication requirements under the TD. The proposal also contains an empowerment to recalibrate the Level 2 prospectus schedules for companies already admitted to trading on regulated markets, so that the information disclosed in the prospectus takes into account the disclosures already made by the issuer under the TD and MAR.

The Commission is currently assessing the national transposition measures for the Transparency Directive and the Accounting Directive, which will allow identifying possible inconsistencies. This includes assessing the claim that there are divergent rules on the notification of major holdings of voting rights.

Compliance costs related to the reporting of non-financial information by large companies were analysed in the impact assessment at the time of adoption (2014). They were considered proportionate and commensurate with the usefulness of the information.

The Commission services are developing a European Single Electronic Format for the preparation of annual financial reports for all issuers of securities admitted to trading on a European regulated market. The draft format is prepared by ESMA and expected to be adopted by the Commission as a regulatory technical standard in 2020.

⁴³ Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.

Finally, on DGSD disclosure requirements, information is an essential element of depositor protection and the annual disclosure sheet under the DGSD is neither excessive nor duplicative. Improved information for depositors was indeed a key concern of the Directive, with the result that no derogations from this provision are envisaged. Nevertheless, the legislators considered that the administrative costs should be kept as low as possible and that depositors' choices regarding the means of communication should be respected. If, for example, a depositor uses internet banking, the information can be made available by electronic means.

4.3. Compliance costs

In addition to compliance costs related to reporting and disclosure requirements, industry respondents raised a number of other concerns about the administrative burdens stemming from regulation. While respondents often provided specific examples of where they perceived the compliance burden to be excessive, limited quantitative evidence was available on the actual compliance costs.

A) General issues

The complexity of EU rules, the perceived overlap between various layers of regulation, poorly aligned and tight timelines for implementation and transposition are seen as challenging in terms of compliance burden on regulated firms. As regards timelines, concerns relate to deadlines being fixed in primary legislation without leaving sufficient flexibility to finalise secondary legislation, which in turn can leave insufficient time for implementation.

Another concern was the consecutive implementation of different rules that require firms to make frequent and consecutive changes to their IT systems. Respondents also called for stability in the regulatory framework and for sufficient time to be allowed to pass before reviewing rules and deciding on targeted revisions.

The financial crisis required an intense and urgent regulatory response, which has indeed posed a significant compliance burden on financial market players, in terms of both amount of new rules and tight implementing deadlines. Now that the regulatory framework has become more stable, these issues are likely to become less relevant. The Commission will duly take them into account going forward.

The Commission services will continue to pay particular attention to the analysis of compliance costs in impact assessments for future legislation. Compliance costs resulting from existing legislation will also be addressed in future evaluations or reviews of the different pieces of EU law.

B) Central repository for EU laws

Various stakeholders reported that the accumulation of regulation and requirements as well as complexity as regards their entry into force/implementation date make it difficult to identify what rules actually apply, induce high costs and risk non-compliance. Some stakeholders call for a portal that would provide access in a systematic and coherent way to all relevant requirements included in EU-legislation.

A central portal for EU law (EUR-Lex) exists already. In addition, the Commission launched a digital transformation process to rationalise, redefine and redesign online communication on EU policy. This exercise would permit presenting EU legislation in the area of financial services and markets in a uniform and user friendly format, providing access to the relevant Legislative Acts, Implementing and Delegated Acts and possible guidance on their implementation.

C) Guidelines issued by ESAs

Many industry stakeholders, in particular from the insurance sector, stressed that the process and the timing of issuance of ESA guidelines create legal uncertainty, as well as unnecessary compliance costs for the industry.

They argued that guidelines are increasingly expansive in relation to their function, namely to ensure the “common, uniform and consistent application of Union law”⁴⁴. In addition, they asked the Commission to avoid any possible overlap between guidelines and secondary legislation, for example by ensuring that ESA guidelines are not issued before the adoption of technical standards.

The overall objective of guidelines is to ensure consistent and effective application of the regulatory framework across the Single Market. They are very useful tools in terms of achieving supervisory convergence and uniform application of EU legislation and have overall been very successful and added significant value to the work of supervisors and financial institutions.

The Commission services will reflect on how to best address the concerns raised in relation to guidelines.

D) Divergent implementation of EU law and national gold-plating

Significant compliance costs may result from divergent and/or inconsistent transposition of EU Directives into national legislation. When transposing EU Directives, Member States sometimes deviate from the text of the Directives or interpret the rules (including definitions) in different ways. Such divergences may undermine the single rulebook and the level playing field and create complexity and additional compliance costs for firms

⁴⁴ Article 16 of the Regulation (EU) No 1094/2010

operating cross-border. This may have a negative impact on the cross-border provision of financial services.

In addition, in several areas some Member States go beyond what is required by EU law when they implement legislation at national level ("gold-plating"). Examples of gold-plating requirements provided by respondents were among others: supplementary requirements for investment funds under AIFMD and UCITS, investor protection rules stricter than those provided in MiFID II, or specific rules protecting SME borrowers.

Correct and consistent implementation of EU law at national level is essential to create a single rulebook, particularly in case of the transposition of EU Directives into national law. An in-depth analysis of national measures is necessary in order to identify specific issues and assess their impact on the functioning of the single market.

Assessment of a large amount of national measures is ongoing, with details to be assessed legislation by legislation. The analysis of any potential negative impact of gold-plating on the cross-border provision of services should consider also the level of harmonisation of EU legislation (minimum harmonisation directives may lead to some extent to differences in the way they are implemented by the Member States) and any possible justifications for exceptions in the way EU rules are transposed, provided by the Treaty.

The Commission services are assessing the national transposition of all financial services Directives focusing on key provisions and, where relevant, also the national measures implementing Regulations. Currently, the Commission is assessing the national transposition of 17 directives. It will continue monitoring the progress of those to be transposed in 2017/2018. This will help identify gold-plating provisions which create undue additional compliance costs. When national measures are identified as incompatible with EU law, the Commission raises the issue with the Member States concerned and starts infringement proceedings if the problem is not resolved. Information on the state of transposition and on enforcement actions by the Commission is published regularly. For the Directives which are still to be transposed the Commission services support Member States to facilitate correct and consistent transposition via transposition workshops and bilateral discussions.

As regards gold-plating, the Commission services are also reviewing, via the Member States' expert group on barriers to free movement of capital as part of the CMU Action Plan, national provisions that create unjustified or disproportionate burden to the cross-border movement of capital. The objective is to prepare a joint roadmap with the Member States for possible actions to remove those national barriers.

E) Divergences resulting from national options

Divergent national rules potentially increasing compliance costs for firms operating cross border may also result from national options included in EU Regulations. The main

example highlighted by the respondents is the Audit Regulation⁴⁵ which concerns audits of Public-Interest Entities (PIEs). Several stakeholders (including companies operating on a cross-border basis, the audit profession and trade associations) argued that the implementation of the Audit Regulation could result in a patchwork of diverging national options on pivotal aspects of the new rules, leading to inconsistencies across the EU and generating extra administrative costs and complexity. Notably, respondents voiced concerns about differing national implementations of the definition of PIEs –as defined in the Audit Directive⁴⁶ - the maximum duration of audit firm engagements, the list of prohibited non-audit services, and the cap on allowed non-audit services. As a consequence of these national divergences, companies operating on a cross-border basis would no longer be in a position to appoint one audit firm to carry out the statutory audit of the whole group, and would need to take into account the specific rules that apply in each of the Member States where PIEs are located. Respondents proposed either to remove provisions in the Audit Regulation granting Member States the choice to adopt national options, or to indicate that the rules of the Member State where the group is headquartered should apply to all the entities of the group, no matter where they are located in the EU.

The implementation of the 2014 reform, whereby co-legislators inserted national options in the Audit Regulation, became applicable on 17 June 2016. Even though during the implementation process, the Commission services have been working closely with Member States, national authorities and stakeholders to reduce possible inconsistencies, significant differences are emerging in the application of the key national options by Member States. Given the limited time elapsed since the entry into force of the new rules, the economic impact of the national options on companies and on the audit firms needs to be further assessed.

As announced in the Commission Work Programme 2017, the Commission services will review, as part of its REFIT program, the national options in the Audit Regulation. In particular, the Commission services intend to establish an overview of the adoption of national options and assess their impact as part of the market monitoring exercise. They will work with the new pan-EU supervisory audit body (Committee of European Auditing Oversight Bodies, CEAOB) on the consistent application of the new rules, with a specific focus on the cross-border impact of mandatory rotation and the black list of prohibited

⁴⁵ Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC.

⁴⁶ Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

non-audit services. The Commission services will also consult on the impacts created by diverging national options.

F) Divergent application of EU law by national authorities

Respondents voiced concerns that EU rules are not always applied correctly and consistently by national authorities. This may result in duplicative or inconsistent requirements for firms and create practical barriers to their cross-border activity.

The ESAs are entrusted with the task of enhancing supervisory convergence and of monitoring implementation of EU law by national supervisors. They may take action to tackle breaches of EU law in the areas under their responsibility.

In the context of the CMU Action Plan, the Commission services are working with ESMA to implement a strategy to strengthen supervisory convergence to reduce regulatory arbitrage and ensure a level-playing field for market participants and investors. ESMA as well as EIOPA and the EBA have indicated in their strategic work programmes that they will dedicate more focus and resources to enhancing supervisory convergence in the next years. ESMA has established a dedicated standing committee on supervisory convergence⁴⁷ and is implementing the first annual work programme on supervisory convergence⁴⁸.

The Commission services are regularly in contact with the ESAs to share information on enforcement matters, in order to identify possible breaches of EU law that may require Commission or ESAs action.

4.4. Barriers to entry

The proper functioning of the single market requires a regulatory framework which facilitates the cross-border activity of companies. To that purpose, the European “passport” is intended to allow financial services operators legally established in one Member State to establish/provide their services in the other Member States without further authorisation requirements.

Some respondents have raised concerns about the suitability and effectiveness of existing EU rules in terms of access to the market in specific sectors (e.g., the credit rating agencies and benchmarks).

⁴⁷ Terms of reference for the Supervisory Convergence Standing Committee, ESMA/2016/229, 27.01.2016

⁴⁸ ESMA Supervisory Convergence Work Programme 2016, ESMA/2016/203, 11.02.2016

Moreover, several respondents pointed to obstacles to the cross-border marketing of investment funds, mainly due to divergent and inconsistent authorisation and passporting requirements.

Finally, the inconsistent implementation of globally agreed rules by other jurisdictions is seen as a source of additional burden for firms operating globally, which may hinder access to international financial markets.

A) Access to the credit rating market

Some respondents raised concerns that, notwithstanding the amendments to the CRA Regulation, the credit rating market is still concentrated. In their view, instead of establishing a level playing field, the current regulatory framework cements the barriers to entry by imposing disproportionate costs on smaller CRAs. The market continues to be dominated by the three biggest players, whereas the market shares of the smaller CRAs are declining. Respondents in particular claimed that Article 8d of the CRA III Regulation⁴⁹ is not sufficient to improve competition and that its implementation should be revisited.

As regards the concerns about Article 8d, the provision has not been fully implemented and enforced at national level. The Regulation gives competence to national supervisors and an effort by ESMA to coordinate their approaches is currently under way.

Based on its mandate in the CRA Regulation, the Commission adopted a report in October 2016 on the state of the CRA market, focusing on four topics: alternative tools to external credit ratings, competition and governance in the credit rating industry, the state of the structured finance instruments rating market and the feasibility of a European Credit Rating Agency. This report includes a preliminary assessment of the concerns expressed by stakeholders on promotion of competition in the market, potential barriers and disproportionate costs facing smaller CRAs. Given that Article 8d of the CRA Regulation and other related articles are still in the process of implementation, the Commission services will continue monitoring the development of the market and maintaining dialogue with stakeholders.

B) Outsourcing by benchmark administrators

Some respondents raised concerns regarding possible "extraterritorial" effect of the Benchmark Regulation (BMR)⁵⁰. They outlined concerns that the requirement in the

⁴⁹ which requires in case of double ratings to consider using at least one CRA with less than 10% market share and if not, to document it

⁵⁰ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of

Regulation related to outsourcing of the provision of regulated data by a benchmark administrator may be deemed to be "extraterritorial" and unenforceable in practice.

The BMR requires benchmark administrators to ensure the integrity of data used in benchmarks, including if the data is transmitted via third parties/outsourced entities. This means that the administrator has to ensure that EU competent authorities can access data and business premises of the third country data providers.

The administrators of so-called "regulated data" benchmarks are concerned that this requirement may create obstacles in case the provision of "regulated data" (e.g., trading data from regulated markets used in an index) is outsourced to entities based outside the EU. Third country data providers may be reluctant to commit contractually to grant the EU national competent authority access to their business premises located outside the EU. As a result, this requirement cannot be enforced and the data provided by these providers cannot be granted "regulated data" status under the BMR, which allows for alleviated regulatory controls. Therefore, a benchmark administrator who relies on such outsourced data may no longer benefit from the alleviated treatment offered to a benchmark administrator using regulated data. They would, in consequence, have to comply with the more stringent conditions for benchmark administrators, notably in relation to the code of conduct. It is, thus, argued that this may hamper effective access and the use of data and data services in the EU.

The BMR entered into force on 30 June 2016. It is still unclear how the Regulation will ultimately affect benchmark administrators and whether the highlighted problem regarding data outsourcing to entities based outside the EU will become an issue in practice. The Commission services will closely monitor the developments in this area.

C) Cross-border barriers in fund management

Stakeholders highlighted that there are still several cross-border barriers in the fund management industry. These barriers arise in part due to differences in the national interpretation of rules, leading to gold-plating and other inconsistencies but also due to the absence of harmonised rules at the European level.

Respondents observed that funds are usually required to comply with different national marketing requirements when passporting into another Member State. Several Member States have introduced significant gold plating, e.g. by imposing supplementary requirements in order to obtain or exercise EU marketing passports under the AIFMD and UCITS Directive. It was highlighted that the rules on marketing to retail investors vary from one Member State to another.

investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

In particular, Member States have also often introduced special administrative arrangements for retail investors concerning subscription, redemption, processing of payments and information requirements. While many of these are technically compliant with UCITS, these arrangements may be seen as outdated and with little value to retail investors.

There are also diverging interpretations of crucial definitions across Member States, which create further obstacles. For example, according to the respondents it seems that national laws transposing the AIFMD contain different definitions for important concepts such as "professional investor", "material change" and "marketing".

Stakeholders also noted that EU funds are subject to significantly different regulatory fees imposed by home and host Member States, both in terms of scale and how they are calculated. National notification processes and differential tax treatments were cited as representing additional barriers.

All of these divergences undermine the single rulebook and a European level playing field. They create complexities and additional compliance costs for financial institutions operating across borders, presenting a disproportionately high burden for small funds in particular. More generally, they act as a hurdle for the cross border trade of financial services thereby undermining a core CMU objective.

The Commission launched a public consultation on 2 June 2016 to gather more detailed evidence on barriers to the cross-border marketing of investment funds. Based on the results, changes may be proposed. National barriers to the distribution of funds are also discussed by the Member State Expert Group on barriers to free movement of capital in view of finding the most efficient ways to remove them, in collaboration with the Member States. The Commission will report on the national barriers identified shortly.

D) Inconsistencies in authorisation and passporting requirements

In addition to obstacles when marketing funds across borders, some stakeholders called for a single authorisation and more harmonised passporting requirements in EU legislation and specifically suggested introducing a single authorisation and passport for investment services. Currently, passporting in the single market for investment services is fragmented according to areas of specialization and require several authorisations.

In the past, the multitude of authorisations and passports which operate in parallel has also raised complex issues of their respective scopes. Indeed, both the UCITS and the AIFMD passport allow a UCITS manager or the manager of an ADR to provide certain MiFID services (individual portfolio management, investment advice, managed accounts or trade execution) as long as these services remain incidental or "non-core" in relation to the management of the UCITS or ADR. The dichotomy between individual portfolio management and collective portfolio (fund) management has spawned a regulatory-driven distinction between investment firms and asset managers.

Consolidating EU passports for various investment and portfolio management services would be consistent with a simpler single rule book and a more cost efficient organisation of the single market for investment services. A single authorisation and passport would cut cost and make it easier to provide investment services seamlessly across the EU. While a single investment service passport could in principle help establishing a CMU, such a proposal would require further analysis.

As a complement to the recent consultation on cross-border distribution of investment funds, a mapping of MiFID/UCITS/AIFMD authorisation requirements and their holders could be performed in order to assess the potential for administrative simplification. The Commission services will also explore the feasibility of simplifying the range of authorisations needed to provide services across the single market.

5. MAKING THE REGULATORY FRAMEWORK MORE CONSISTENT AND FORWARD-LOOKING

Rather than being the result of design weaknesses, unintended consequences of regulation seem to arise quite often from factors outside the direct objective of the legislation. Relevant factors could be beyond the usual cause and consequence reasoning that underlies policy debates and the information received in this consultation suggests that they often arise from changes elsewhere in the financial framework conditions that become relevant for the effectiveness of individual regulatory measures.

Particularly valuable in this respect has been evidence that point to unintended consequences of regulation caused by changes in other parts of regulation. These are discussed below in section 5.1 (unintended interactions and inconsistencies between legislations).

A second important set of relevant factors is related to the impact of regulation on the end-use and specifically its inaction with consumer protection issues. The likely reason for insufficient regard of this factor in the design of regulation is the fact that end-users are underrepresented and less involved in policy dialogues (see section 5.2).

Gaps in the regulatory framework can be considered a third important additional factor. Unintended consequences emerge from structural changes the new legislation induces or simply from escape strategies. A straightforward example is that the focus of the EU financial regulation to make the banking system safer may have shifted financial activity to non-banks (see section 5.3).

Finally, technological change is a rather obvious factor that may be overlooked in the design of regulation, though it is difficult to tackle. Financial regulation may have a different impact in a different technological environment. And that regulation may either foster or impair technological progress is also of relevance in this context. The rising importance of the so-called FinTech sector illustrates this point (see section 5.4).

5.1. Unintended interactions and inconsistencies between legislations

A wide range of stakeholders commented on the unintended interactions and inconsistencies between different legislations. Respondents emphasised the importance of undertaking regular assessments and called for future impact assessments to take better account of unintended interactions and possible inconsistencies of new rules with existing rules.

The following examples of inconsistencies have been highlighted by respondents:

- Inconsistencies between asset segregation rules;
- Inconsistencies between prudential banking rules and prudential insurance rules;

- Inconsistencies between prudential banking rules and accounting rules;
- Inconsistencies between financial conglomerate rules and sectorial legislation;
- Inconsistencies within the existing EU macro-prudential policy framework;
- Inconsistencies between prudential insurance rules and market infrastructure rules;
- Inconsistencies between sanctioning regimes across EU legislation;
- Inconsistencies in definitions across EU legislation;

Several of these inconsistencies merit follow up, as discussed below. At the same time, some perceived inconsistencies are intentional differences between rules that aim at achieving different objectives and/or were the result of political compromises reached during negotiations.

A) Inconsistencies between asset segregation rules

Asset segregation rules streamline the traceability of assets in the custody chain and thereby aim to increase investor protection, i.e. to avoid situations where assets are seized to pay third party creditors. Asset segregation rules currently play a vital role in the protection of investors when financial institutions default.

Some respondents claim that the wording and interpretation of asset segregation rules in different EU laws are inconsistent. According to CSDR, CSDs should provide segregated securities accounts for each participant. Furthermore, CSDs and their participants should offer both omnibus client segregation and, if required, individual client segregation. Clients are thus given the possibility to choose the level of segregation they need. The same holds for EMIR rules that apply to CCPs.

However, following AIFMD and UCITS rules, assets held on behalf of AIFs and UCITS funds must always be segregated by the depositaries on a client-by-client basis and by each (sub)custodian, to whom the depositary has delegated the safe-keeping/custody functions, on a depositary-by-depositary basis with two omnibus accounts for all AIFs and all UCITS assets. The AIFMD and UCITS asset segregation requirements are accompanied by further safeguards such as rules on re-use.

The segregation requirement as regards (sub)custodians is the main bone of contention raised by respondents. According to some respondents, the (sub)custodian industry practice has arguably been to use a single omnibus account to pool all AIFs' and UCITS funds' assets of all depositaries together. They argue that the AIFMD and UCITS requirements only increase operational complexity, potentially leading to more errors due to the multiplication of accounts, without bringing any additional benefits in terms of client asset protection. Some respondents also mentioned that enforcement of segregation requirements varies across the EU, whereby the AIFMD and UCITS requirements are clearly enforced in some Member States, whilst the industry still operates legacy single omnibus accounts in others. In this context, respondents called upon the Commission to ensure supervisory convergence.

Consistent interpretation of asset segregation rules under AIFMD and UCITS should foster legal certainty and ensure supervisory convergence.

In June 2016, ESMA published a call for evidence on asset segregation and custody services under AIFMD and UCITS Directives, which closed on September 23. ESMA had already consulted on asset segregation under the AIFMD in December 2014, but the 2016 call for evidence had a broader scope, as it also covered asset segregation rules under the UCITS Directive and any residual uncertainty on how the depositary delegation rules should apply to CSDs. ESMA is particularly interested in gathering views on other potential asset segregation regimes that ensure clear identification of assets as belonging to a specific AIF or UCITS, and that provide investors with appropriate protection through clear attribution of the assets in the event of insolvency.

B) Inconsistencies between Solvency II and CRR/CRDIV

Stakeholders provided a number of examples of possible inconsistencies between CRR/CRDIV and Solvency II.

A first difference between the two regimes relates to the treatment of the guarantees from non-central governments. Whereas the CRR/CRD IV allows for a specific treatment of credit exposures to unrated regional governments and local authorities subject to supervisory discretion, Solvency II does not. According to Solvency II, when an investment benefits from a public authority guarantee, a zero risk weight would only apply to central government guarantees, and not to local and regional authorities, which could present a constraint for the financing of the health sector, education, etc. This also negatively affects regional promotional banks whose bonds issuance typically benefits from such guarantees.

A second inconsistency highlighted by respondents relates to the detailed eligibility condition of certain own fund instruments (e.g. capital hybrids), which may receive significantly different treatment for insurers and credit institutions, even though their actual financial loss absorbency may be similar.

The Commission services consider that the rules should be assessed for their consistency across sectors, taking into account the unavoidable differences between the business models of the financial institutions. As a first step, on 18 July 2016 the Commission issued a call for advice to EIOPA on the review of 17 specific items in the Solvency II delegated regulation. Among other things, EIOPA is indeed tasked to analyse the differences between the banking and insurance framework in the treatment of regional governments and local authorities and in the treatment of exposure guaranteed by a third party and to assess whether these are justified by differences in the business model of the two sectors. EIOPA is also asked to also follow the same approach with regards to inconsistencies in the treatment of certain features of own funds items (e.g. certain debt instrument) within the insurance and banking framework. The technical advice will feed

into the review of the Solvency II delegated act where these issues are intended to be addressed.

C) Interaction between IFRS9 and CRD4/CRR

The interactions between accounting standards and prudential and supervisory rules are perceived by stakeholders as burdensome, overlapping and sometimes in contradiction. Respondents generally complain about divergences of criteria and definitions between banking legislation (CRR/CRDIV) and IFRS 9 requirements, in particular in relation to loan loss provisioning and the calculation of capital. They also raise concerns about the outcome of the ongoing consultations on guidelines in the Basel committee and EBA, which add uncertainty to how IFRS 9 should be applied. Also, respondents worry about the different dates of entry into force of legislations and guidelines, which in their opinion could create uneven effects between banks.

The application of the expected credit loss provisioning introduced by the revised international accounting standards on financial instruments "IFRS9", may lead to a sudden decrease in the capital ratios of institutions. The results of the first impact assessment published by the EBA in November 2016⁵¹ show for example that the estimated impact of IFRS 9 is mainly driven by IFRS 9 impairment requirements. The estimated increase of provisions is on average 18% compared to the current levels of provisions under IAS 39 with an average decrease of 56bps for common equity tier 1 (CET1) ratios. Discussions on possible prudential treatments on the impact of increased expected credit losses are still ongoing. In light of this, the incremental provisioning for credit risk of IFRS 9 is being phased-in in the CRR2 package so as to prevent an unwarranted impact on lending by banks.

D) Interaction between FICOD and sectoral legislation

Financial conglomerates are large financial groups which provide services and products in at least banking/investment and insurance. The Financial Conglomerates Directive (FICOD)⁵² aims at identifying and managing risks that are inherent to these groups that are active in several financial sectors to ensure financial stability. FICOD therefore focuses on the so-called "group risks" - i.e., potential risks of multiple gearing and

⁵¹<https://www.eba.europa.eu/documents/10180/1360107/EBA+Final+draft+report+on+impact+assessment+of+IFRS9.pdf>

⁵² Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council.

excessive leveraging of capital, risks of contagion, risks related to management complexity, risk concentration, and conflicts of interest.

Some respondents argue that FICOD should be reviewed in light of changes to sectoral legislation. Other respondents call for reconsidering the merits of supplementary supervision when sectorial requirements already cover all risk, in particular because Solvency II's enhanced group regime reduces the relevance for insurance-led conglomerates. Some stakeholders argued that certain market operators (e.g. exchanges, central counterparties) owned by conglomerates should be clearly excluded from consolidated supervision although settlement systems (CSDs) could be included. Some respondents also argue that the application of CRR consolidated supervision to mixed financial holding companies with a primary insurance nature has unintended consequences. Financial conglomerates, as identified under the Directive, which are predominantly insurance in nature but with significant banking activities in the group may, for example, need to comply with all the CRR capital, own funds, large exposure, liquidity and leverage requirements on a consolidated basis (which are developed and tested by impact studies on credit institutions). This is deemed excessive, since the comprehensive Solvency II group requirements already apply.

As part of the evaluations carried out under its 2016 Regulatory Fitness and Performance Programme ("REFIT"), the Commission launched in June 2016 a consultation to gather evidence on whether the current FICOD regulatory framework is proportionate and fit for purpose, and delivering on its objective to identify and manage group risks. In line with better regulation principles, the evaluation will assess the relevance, effectiveness, efficiency, coherence and EU added value of the legislation. The consultation closed in September 2016 and the issues identified in the call for evidence have fed into the evaluation exercise (including the issue of the application of CRR consolidated supervision to mixed financial holding companies with a primary insurance nature).

E) Inconsistencies in the macro-prudential toolkit

Several respondents consider that the EU macro-prudential framework is unduly complex, hindering its efficiency, effectiveness and predictability of supervisory action. The existing overlaps between different macro-prudential instruments, their varying complexity and their diverse activation procedures are seen as blurring the transparency of the framework. There is also a perceived lack of clarity in the context of legal sanctions in the case of breaches of capital requirements and the role of different macro-prudential capital buffers therein. They thus consider it important that the macro-prudential toolset be further streamlined at EU level. Others call for specific revisions in the rules and procedures governing specific macro-prudential instruments, for instance, the "cumulation" rules governing buffers for systemically important institutions and the systemic risk buffer (SRB), as well as the indicators used in calibrating institution-specific capital buffers.

Banks and industry associations claim that the design of systemic risk regulation, in particular in terms of the calibration of the buffers for global systemically important institutions (G-SIIs) and for domestic/other systemically important institutions (O-SIIs), presents inconsistencies and can create misaligned incentives, while also unduly raising regulatory costs. They are concerned that macro-prudential buffers are currently not applied consistently in all Member States which exacerbates uncertainty and complicates appropriately estimating the impacts of the whole capital framework. In addition, they argue that the "cumulation" of Pillar 1 and Pillar 2 capital requirements and macro-prudential measures may entail unnecessary regulatory burdens as they simultaneously target the same risks (duplication of risk targeting, for example, in terms of requirements for real estate credit risk).

Some industry respondents also point to a disproportionate burden for particular segments of the EU banking sector following the activation of some macro-prudential instruments, in particular the SRB and the O-SII buffer, especially as compared to the overall lower requirements for some globally systemic banks. In this regard, the complexity of the framework and the possible duplication in risk targeting associated with different macro-prudential instruments are seen as unduly increasing the regulatory burden, in particular on small institutions with simple business models.

The Commission services are currently undertaking a comprehensive review of the EU macro-prudential policy framework. The review seeks to address potential deficiencies in the capacity of the EU macro-prudential framework to tackle systemic risks, while preserving an adequate balance between national flexibility to deal with country-specific vulnerabilities, and appropriate coordination and common control mechanisms to safeguard the single market and manage cross-border spill-overs of national policies. Addressing concerns expressed by respondents, key objectives of the review include increasing the efficiency and effectiveness of the macro-prudential toolset for banks by reducing the scope for duplication in risk targeting, circumvention of control mechanisms envisaged in the framework, undue 'stacking'/cumulation of capital buffers and disproportionate increases in the regulatory burden. A public consultation on these matters ended on 24 October 2016⁵³.

F) Inconsistencies between Solvency II and EMIR

EMIR introduced several requirements for financial counterparties of OTC derivatives contracts. This Regulation applies also to insurers, which are allowed under Solvency II to use derivatives instruments insofar as they contribute to a reduction of risks or facilitate efficient portfolio management⁵⁴. In their responses, insurers pointed out that

⁵³ http://ec.europa.eu/finance/consultations/2016/macprudential-framework/index_en.htm

⁵⁴ Article 132(4) of the Solvency II Directive.

while EMIR considerably reduced counterparty risks related to derivatives, Solvency II does not take this improvement into account in its capital requirements. In particular, stakeholders raised two issues:

- Consistency of haircuts to collateral applied in Solvency II with haircuts introduced by EMIR, depending on the related market risk⁵⁵;
- EMIR requires to clear derivatives through central CCPs or to exchange margin for bilateral contracts⁵⁶, thus significantly reducing the counterparty default risk, while Solvency II does not explicitly take this into account.

Solvency II includes capital requirements for derivatives in order to address the related counterparty default risk. These capital requirements have been set out in a pre-EMIR context and do not yet account for potential counterparty risk reduction through clearing requirements, and do not discriminate between CCP and OTC derivatives. In addition, no specific approach has been set out to value CCP exposures.

On 18 July 2016 the Commission issued a call for Advice to EIOPA on the review of 17 specific items in the Solvency II delegated regulation. Among other things, EIOPA is indeed tasked to suggest how the Solvency II framework could be updated in its approach to cleared derivatives to take account of the reduced counterparty risk introduced by EMIR. Moreover EIOPA is asked to develop a new approach, on exposures to qualifying central counterparties. The technical advice will feed into the review of the Solvency II Delegated Act where these issues are intended to be addressed.

G) Inconsistent sanction regimes

Several stakeholders, in particular public authorities, claimed that the provisions on administrative penalties included in different EU legal acts are inconsistent. This complicates the application of penalties and increases the administrative burden for competent authorities. Stakeholders highlighted inconsistencies especially in the following areas:

- Divergent level of fines – this includes both differences in the calculation of the fines as well as differences in fines for natural and legal persons;
- Publication of sanctions – this concerns factors such as the timing, the object of publication and conditions for exemption or anonymous publications;

⁵⁵ Article 46(1) of EMIR

⁵⁶ Article 4 of EMIR (clearing obligation), and Article 11(3) of EMIR (bilateral exchange of margin)

- Reporting of sanctions to the European authorities – the scope of the information to be reported differs across different legal acts;

Various industry respondents furthermore claimed that sanctions are sometimes disproportionate to the seriousness of the breach. These concerns were raised in particular with regard to the TD. It was stated that: different amounts do not reflect the importance of the duties breached; that sanctions for failure to notify major holdings are sometimes excessive; that setting out maximum fines only is insufficient to ensure proportionality; and that sanctions should be applied to companies/managers rather than employees who follow instructions. Furthermore, it was stressed that suspension of trading under the TD can only last for a maximum of 10 days, even if the reason for suspension is still valid. This implies that suspension has to be re-published every 10 days, which is burdensome.

Sanctioning powers, like the level of fines, are sometimes deliberately different in different pieces of EU rules to tailor the sanctioning powers to the specifics of the sectors or breaches concerned. The large majority of inconsistencies highlighted, however, arise due to the outcome of the negotiations between the co-legislators. Given that the setting of sanctions, especially criminal ones, is traditionally a competence of Member States, only minimum harmonisation agreements have been possible to date.

The Commission services will monitor the application of sanctions and encourage the ESAs to focus on enforcement issues, also in order to evaluate the actual effectiveness and proportionality of sanctions.

H) Inconsistent or unclear definitions

A frequent issue raised by stakeholders relates to the need for further clarification and/or consistency of definitions. The definitions that have been raised a significant number of times are:

- market-making definition;
- definition of financial instruments;
- professional client definition; and
- safekeeping/custody definition.

In general, there are no specific indications that the inconsistencies identified by stakeholders would cause important problems and there are only limited indications that changing the definitions would bring added value.

The Commission does not control the legislative process, so it cannot impose consistency of definitions, also because legislation may already exist and changing this might impose significant costs on market participants. However, the Commission can propose

definitions that are as consistent as possible with the existing ones. The Commission can also explain why it cannot use the existing definitions in specific cases.

The Commission services will aim at providing definitions that are as consistent as possible with the existing ones and, if applicable, explain why it cannot use the existing definitions in specific cases.

A recent example is the definition of commodity derivatives and foreign exchange spot and forward contracts under MiFID II which have been clarified further in the MiFID delegated regulation adopted by the Commission on 25 April 2016. Articles 5-8 specify which commodity contracts are deemed financial instruments. Furthermore, Article 10 of the same Regulation describes which foreign exchange contracts are in the scope of MiFID II.

Going forward Commission services will look in particular at the definitions of professional investor, safekeeping and custody.

5.2. Retail investor and consumer protection

Consumer associations highlighted that consumers' trust in financial service providers is still low. They believed that proper and efficient enforcement of EU law is crucial in order to enhance consumer confidence in financial services, particularly in light of the CMU and the single market for retail financial services.

However it is worth noting, as recognised by consumer representatives, that most of those new or revised laws have only recently entered into force, or are about to enter into force (e.g. MiFID II, Packaged retail and insurance-based investment products "PRIIPs" Regulation⁵⁷ and Payment Services Directive "PSD2"⁵⁸) while some are still in a transposition phase (e.g. Insurance Distribution Directive "IDD"⁵⁹, Payments Account

⁵⁷ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

⁵⁸ Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

⁵⁹ Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast).

Directive "PAD"⁶⁰ and Mortgage Credit Directive "MCD"⁶¹). As a result, it is too early to assess their impact on consumers, and the focus should now be predominantly on the implementation and enforcement of these new rules.

Nevertheless, while acknowledging that recent EU legislation is to benefit consumers and competition in the market⁶², some consumer representatives have continued to point to a few issues that, in their opinion, still need to be addressed. One such issue is the incomplete or uneven enforcement of EU consumer protection rules, hindering the emergence of a truly single market for financial services: consumer representatives claim that national supervisors are not always equipped to ensure proper consumer protection supervision (lack of sufficient resources and effective sanctioning powers), especially cross-border (lack of supervisory cooperation). In addition, national out-of-court redress procedures do not consistently ensure efficient settlement of disputes between consumers and financial services providers, thus creating non-tariff barriers in the internal market.

Moreover, a number of respondents from the financial industry raised the issue that pre-sale information requirements to retail clients are excessive and duplicative across different pieces of legislation (e.g. PRIIPs regulation, IDD, Prospectus Directive, Solvency II, MiFID/R, and UCITS). Many submissions in this context challenged the effectiveness of information provided to retail clients. The format of disclosure⁶³ is presented as burdensome and confusing for the end user. On the other hand, consumer representatives are more concerned about inconsistencies in the rules applicable to the distribution of financial products (e.g. inducement payments, commissions).

It should be noted that many of the submissions received were also made in the responses to the public consultation on the Green Paper on Retail Financial Services. In the first months of 2017, the Commission services will publish an Action Plan setting out steps it plans to take to build a deeper single market for retail financial services. Among other things, these steps will include actions to improve awareness around out-of court

⁶⁰ Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features.

⁶¹ Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

⁶² Some examples are: enhanced transparency on financial advice provided to consumers under MiFID II, key information document "KID" under the PRIIPs regulation to counter the increasingly complex information accompanying financial retail products, the legal right to a basic payments account under the PAD, responsible lending obligations, right to conversion into an alternative currency, as well as to early repayment under the MCD

⁶³ Not to be confused with the medium of disclosure; see section on technological developments.

settlement options for cross-border disputes and to look further into disclosure requirements and assess whether these are fit for purpose in the digital world. Finally, in the context of the CMU Action Plan, the Commission services will undertake a comprehensive assessment of European markets for retail investment products; the assessment will include the efficiency of distribution channels and the effectiveness of investment advice in ensuring retail investors find their way to products and services that suit their needs.

A) Improved out-of-court complaint and redress procedures

Consumer associations are concerned about the lack of effective enforcement and sufficiently dissuasive sanctions in the retail financial services. They argued that out-of-court complaint and redress procedures may be ineffective in terms of improving consumers' protection since financial services providers are not obliged to subscribe to them.

Out-of-court procedures may facilitate private enforcement of consumer/investor rights. Under the Directive of 2013 on Alternative Dispute Resolution (ADR), Member States are required to ensure that such procedures are available to consumers. In the retail financial sector, the FIN-NET network is available to facilitate settlement of cross-border disputes between consumers and financial services providers. These mechanisms can be used on a voluntary basis. Making participation mandatory for financial firms is already envisaged in the Mortgage Credit Directive. The Commission services will verify how Member States transpose that compulsory participation into national law to assess to what extent the issue is addressed.

The Commission services established an informal network tool to share information with the ESAs on enforcement matters. The Retail Financial Services Action Plan will look at issues around consumer awareness regarding FIN-NET and the divergence of powers between different ADR regimes.

B) Pre-sale disclosure requirements across different pieces of legislation

Respondents from the financial industry raised the issue that pre-sale information requirements to retail clients are of a duplicative nature. Many submissions in this context challenge the effectiveness of information provided to retail clients. The information is presented as burdensome and confusing for the end user. Another aspect is the increase in the absolute number of information items required; criticism of the increased amount of required information has come in particular from the insurance sector.

For example, according to several responses from the insurance sector, consumers are overwhelmed by the increasing number of pre-sale information items to be disclosed respectively under PRIIPs, IDD, and Solvency II⁶⁴. They also claimed that the pre-sale information requirements are duplicative across these legislations⁶⁵.

The Commission services analysis finds that IDD requirements rather than being duplicative in fact complement PRIIPs requirements⁶⁶. As regards PRIIPs-Solvency II duplication concerns, it is important to clarify that Solvency II provision on "Information for policy holders" is contract-specific, entailing a disclosure obligation before and during the contract, whereas the PRIIPs Key Information Document (KID) is product-specific.

Moreover, respondents from the industry (predominantly from the banking sector) acknowledged the objective of enhancing investor protection via the additional MiFID II requirements on disclosing all relevant costs attached to a product or service. Having said that, they are concerned that the overall positive effect might be reduced where clients are provided with an additional document. Respondents called for further aligning MiFID II rules such that an investment firm, acting as a distributor, can fulfil its disclosure obligations under MiFID II through the KID (PRIIPs), or Key Investor Information Document "KIID" (UCITS).

However, MiFID II requires investment firms to disclose all costs and charges relating to the service and the product being offered. The investment firm can rely on the PRIIPs KID to disclose information on the product. It must, however, additionally inform clients about the costs and charges related to the distribution of PRIIPs, as such cost elements may not be included in the PRIIPs KID. As the UCITS KIID does not disclose all the costs as required by MiFID II (e.g. transaction costs), MiFID II intermediaries cannot *fully* rely on the UCITS KIID. They have to liaise with the UCITS management company

⁶⁴ In particular, the number of pre-contractual information increases from twenty under the Life Insurance Directive (Directive from 1979, recast in 2002) to sixty-six under Solvency II (Directive from 2009) and PRIIPs Regulation (Regulation from 2014), while the disclosure requirements for sales rules would rise from nine under IMD (Directive from 2002) to thirty-five under IDD (Directive from 2016).

⁶⁵ Stakeholders stressed that PRIIPs and IDD contain similar provisions on the disclosure of costs and charges with no acknowledgment in either piece of legislation for the requirements to be met by the other. On the other hand, they also stressed that both PRIIPs and Solvency II require equivalent information to be disclosed on the insurer's identity, the duration of the contract and the existence of complaints procedures.

⁶⁶ Whereas the PRIIPs KID is to be produced by the product manufacturer, IDD requires additional information to be disclosed by the insurance distributor on the specific cost of distribution relating to that product

to obtain additional information on transaction costs as well as costs related to distribution. Therefore, pre-contractual disclosure requirements complement one another rather than overlap.

Finally, a number of industry representatives pointed that while the PRIIPs regulation stipulates a temporary exemption⁶⁷ (until 31 December 2019) from its scope for UCITS⁶⁸ it does not include a similar exemption for insurers providing unit-linked insurance contracts offering switching between different, often multiple, UCITS options. They argued that in order to fulfil their obligations under the PRIIPs regulation, the insurers will need to disclose PRIIPs relevant information for each underlying investment option. The claim points to a practical difficulty when underlying instruments are numerous and varying, and as a result a detailed description of individual instruments would render disclosure highly complex.

In general, the different pieces of pre-sale information are designed to meet different objectives related to investor protection. Nonetheless, potential inconsistencies can be assessed and addressed in the relevant reviews as well as in the context of the wider assessment of retail investment markets under the CMU Action Plan.

Moreover, the Retail Financial Services Action plan will look at how to monitor different disclosure requirements in the digital world and collect evidence of the risks and benefits with a view to address some issues later, possibly through legislative action (see also "financial information and disclosure and digital technology" under 5.4.B).

C) Transparency of distribution costs

Whereas the submissions from the financial industry focused on highlighting excessive pre-sale information requirements, the consumer associations pointed at the inconsistencies in the rules applicable to the distribution of financial products (e.g. inducement payments, commissions).

A number of consumer representatives argued about the misalignment of the various regulations addressing the transparency of distribution costs (e.g. inducement payments, commissions). As a result, similar retail financial products and services may be less or more transparent depending on the type of distribution channel. Such differences could also be responsible for the lack of competition in some of these markets. Consumers may be presented with a biased and reduced choice of products and fail to 'shop around' for the product that satisfies their needs best.

⁶⁷ See Article 32 PRIIPs.

⁶⁸ This also applies to AIFs obliged to provide the UCITS KIID under national law.

For example, IDD requires that a fee, commission or a non-monetary benefit “does not have a detrimental impact on the quality of the relevant service to the customer”. In contrast, MiFID II provides that inducements are allowed as long as they enhance the quality of the relevant service to the client. As a result the consumer may be presented with a different level of investor protection, depending on the type of product it acquires.

In general, the IDD aligns the consumer protection rules to the investor protection rules of MiFID II in order to avoid any gap. However, as regards the issue of inducements, the organisation and the size of the insurance distribution sector is typically different from investment firms, and the activity itself is of a different nature. Also, insurance distribution structures can be very different across Member States. The IDD – unlike MiFID II – is a minimum harmonisation instrument acknowledging these differences and giving flexibility to Member States in organising their respective insurance distribution structures.

Consequently, there is no overall ban on commissions under IDD, leaving Member States the choice to impose such a ban or not. Furthermore, there is no "independent advice" in the sense of MiFID II under IDD, due to the nature of the market. Importantly, however, both legislative texts are similar in their objective to restrict the acceptance of inducements. The inducement provisions in IDD differ slightly from MiFID II (to reflect the distribution specificities described above) in providing a negative test for inducements instead of a positive one in MiFID II. The co-legislators explicitly included a different wording under IDD establishing this difference in approach.

Notwithstanding the difference in approach, the scope of possible alignment between IDD and MiFID II is currently the subject of a thorough analysis. A public consultation was launched by EIOPA on 4 July 2016. EIOPA Technical Advice on IDD level 2 measures is expected to be delivered to the Commission in 2017.

With regards to the provision of advice (which is currently regulated product by product), the Retail Financial Services Action Plan will examine the possibility to encourage provision of independent, holistic advice empowering consumers to take informed decision meeting their needs.

D) Investor compensation scheme

The Investor Compensation Scheme Directive (ICSD)⁶⁹ provides the last resort protection in the event of failure of an investment firm. A number of public authorities and consumer representatives called for the Commission to update it as it was considered outdated (given its adoption in 1997).

⁶⁹ Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes.

In particular, some stakeholders called for the Directive to be updated in order to clarify the services it covers, to reflect modern investment methods, inflation, the higher values (on average) of investments than under the current compensation level of €20.000, and to reassure investors across borders about applicable levels. Moreover, the Directive does not take into account the progress made with the adoption of MiFID I (and more recently MiFID II), meaning that it does not offer protection in relation to some investment services and products under MiFID. It also does not reflect parallel developments in the DGSD. The minimum harmonisation nature of the ICSD has led to different levels of compensation across the EU, with consequences not just for investor protection but also the functioning of the single market for investment services. Finally, there are also concerns about the level-playing field between providers of investment services (covered by the ICSD) and banks given that the DGSD covers banking products and term deposits.

The Commission services will give further consideration to this point. It should be noted that in 2010, the Commission had already adopted a proposal to amend the ICSD. This proposal was withdrawn in 2015 within the Refit framework to reduce the number of legislative proposals.

5.3. Gaps and remaining risks in the regulatory system

The regulatory debate is paying increasingly attention to systemic risks that can emerge in the financial sector outside the banking system, considering a potential shift of activities to non-bank entities that are subject to less stringent regulation than banks and that are supervised without a systemic risk perspective. The replies received gave various examples of where a shift of risks from banking to less or non-regulated parts of the financial system has been taken place or is expected to take place. Several flagged the increasing importance of CCPs, while others reported on various parts of the so-called shadow banking sector.

A) CCP recovery and resolution framework

As a result of the EMIR requirements for the central clearing of standardised OTC derivatives, CCPs have grown in importance. A shift of financial activity towards CCPs is warranted and expected to reduce counterparty risk, even if the concentration of business in CCPs may imply concentration of risks and higher costs for those actors that request tailor-made OTC products for hedging their exposure. While the CCPs' business model is not particularly risky, their size and central role gives rise to new vulnerabilities in the form of risk concentration, complex interdependencies with clearing members and collateral scarcity

While being a low-probability event, the failure of a CCP could, via its central position in the markets and notably its direct links to banks, cause widespread contagion within the financial system, unless managed in an orderly manner. Moreover, authorised CCPs

provide their services across borders and, accordingly, the failure of a CCP would imply spillover effects between Member States. The fragmentation of the EU Single Market during the recent crisis clearly demonstrates the danger of relying exclusively on divergent national regimes to manage the failure of financial institutions with cross-border reach.

It is widely acknowledged that an EU-wide recovery and resolution framework is most urgently required for CCPs. A legislative framework is required that empowers relevant authorities to address this financial-stability risk by rapidly restructuring and winding-up the operations of a CCP in an orderly way in case of threatened systemic failure. In addition, legislative measures should provide incentives for sound risk management of CCPs and protect the clients of the large banks which use the CCPs clearing services, and taxpayers from large losses in the event of resolution.

A European framework for recovery and resolution of CCPs would ensure more effective crisis management and less market fragmentation. It would foster a coordinated execution of actions across Member States, a level playing-field for the institutions concerned and an equal treatment of their owners, creditors and customers. In this way, the existing EU and national prudential rules would also be enhanced by the EU recovery and resolution framework.

One of the Commission's stated priorities was to complete the financial reform agenda by addressing remaining risks, notably linked to entities that are systemically important, including CCPs. The Commission's proposal for a recovery and resolution framework for CCPs is in line with this priority.

B) Macro-prudential framework beyond banking

There is an international consensus that systemic risks in the financial system as a whole, and not just banks, should be carefully monitored and addressed. The recent crisis has shown that any public intervention to address risks in financial institutions should be swift and with minimum recourse to taxpayer funds. The Financial Stability Board (FSB), a top-level international grouping of regulators working under the aegis of the G20, has also prioritised this work. This priority is also reflected in the views the Commission received. Some respondents argued that in part as a consequence of stricter regulation on banks, but also driven by other factors such as the low interest rate environment and a search for yield by investors, the potential for risks shifting to financial institutions in the non-bank sector has increased.

A shift towards market-based finance does not necessarily mean higher systemic risk. Activities without any maturity transformation involved, and where the entities involved exhibit low leverage and limited liquidity risk, typically do not threaten financial stability as they are less prone to spreading contagion across the financial system. Yet, there are historical cases when non-bank financial institutions contributed to systemic risk, often

because of their key role in some markets, and their interconnectedness with the banking sector.

Analyses by the ESRB, ESMA and other financial institutions have carefully looked into how different non-bank actors could spur systemic risk, including for example insurance, investment funds and ETFs. They identified data gaps in some parts of non-banking and are establishing risk metrics that are crucial for the monitoring of systemic risks in non-bank entities and activities. They also noted a lack of a macro-prudential toolkit for the non-bank sector, for example instruments that target insurers or allow authorities the use of margins and haircuts as macro-prudential instruments.

In the EU, non-banking financial entities are already subject to a number of rules such as those contained in the AIFMD, UCITS, SFTR, EMIR, as well as the CRR/CRDIV that should make them resistant to financial stress. The existing regulatory toolkit allows supervisory authorities to take a wide range of actions to mitigate potential vulnerabilities from the shift of activity to non-banks. As some of the new rules are still to be phased in, their effectiveness is still largely untested. There is therefore a valid concern that the existing rules may not be effective in preventing the built up of excess leverage in good times or of sufficiently containing adverse effects in times of systemic risk.

At this stage, available evidence does not indicate that potential risks from more market-based finance – including from non-bank entities and activities – are of systemic dimension. A number of measures in both sectorial and market legislation have been agreed and are about to be implemented. In order to assess their effectiveness and spot potential gaps, as well as to anticipate possible sources and transmission channels of new risks, intensive monitoring is warranted and is carried out by the Commission and in European (ESRB) and international fora (FSB). At this stage, it is important that supervisors continue their analysis and integrate into their monitoring process information from the new data sources as soon as they become available. Once the full effects of existing measures tackling both current risks and possible new emerging risks related to certain non-banking entities and activities are evaluated, steps towards the development of a macro-prudential framework beyond banking in the medium term can be considered.

The Commission launched a public consultation between 1 August and 24 October 2016 to obtain evidence and feedback on the functioning and necessary improvements of the EU macro-prudential framework. The consultation also sought views and evidence on financial stability risks stemming from non-bank entities and their activities, and on the need to expand the macro-prudential framework beyond banking. The ongoing macro-prudential review is assessing possible stability risks from growing market-based finance. It's also assessing the need for enhanced risk monitoring (supported by targeted revisions to certain ESRB governance arrangements), mandatory coordination and data sharing among national non-bank supervisors, the ESAs and the ESRB. This approach is consistent with the Commission's objective to strengthen the supervisory framework in

order to ensure the solidity of all financial actors and further supervisory convergence to reap the full potential of CMU.

C) European deposit guarantee scheme

A few responses were received on the creation of a pan-European deposit guarantee scheme. While recognising that a European scheme completes the Banking Union and contributes to breaking the sovereign-bank nexus, some raised concerns about moral hazard risk and the need to protect local Institutional Protection Schemes (IPS). Measures should ensure that more solid banks would not be used to compensate depositors of ailing banks (e.g. risk-based contributions).

The DGSD has been recently amended to further harmonise coverage levels and pay-out procedures of national deposit guarantee schemes. Those amendments entered into force in June 2014. Given the integration of the euro area banking system, in November 2015, the Commission tabled a proposal for a "European Deposit Insurance Scheme" (EDIS) to strengthen the Banking Union, buttress bank depositor protection, reinforce financial stability and further reduce the link between banks and their sovereigns, building on the existing system composed of national deposit guarantee schemes. The EDIS proposal includes actions to deal with most of the respondents' key concerns. The proposal is currently under negotiation in the Council and Parliament.

The Commission services have undertaken further analysis on benefits and costs of a pan-EDIS to complement the November 2015 proposal. This non-paper⁷⁰ published by the Commission services in October 2016 provides additional data and analysis to support the current negotiations.

D) EU personal pension product

Some stakeholders highlighted the need to develop pan-European personal pensions arguing that this would support a more mobile EU workforce (which will also help EU employers). Moreover, certain efficiencies in cost, management and administration can be achieved by pooling assets on a cross-border basis, benefitting EU savers and the EU capital markets. The advantages of pan-European personal pensions have also been put forward by many respondents to the CMU green paper.

As part of the CMU action plan, the Commission is exploring through a public consultation⁷¹ and a study what can be done to support cross border provision of

⁷⁰http://ec.europa.eu/finance/general-policy/docs/banking-union/european-deposit-insurance-scheme/161011-edis-effect-analysis_en.pdf

⁷¹ Consultation on Capital Markets Union: Action on a potential EU personal pension framework, 27.7.2016

personal pension products so that consumers can benefit from a wider range of products, competing across borders. Options under consideration include an EU legislative initiative to boost the development of private pensions as a way to build additional retirement saving to complement state and occupational pensions.

E) Crowd-funding

Some stakeholders call for minimum EU regulation on crowd-funding to ensure investor protection while enabling this funding channel to develop. In contrast, others state that the Commission should not intervene with legislation but continue to work with Member States to gather evidence on the performance of crowd-funding and consider what lessons can be learnt and applied to help foster the growth of crowd-funding across the EU.

The crowd-funding report published by the Commission in May 2016 takes the view that, given that markets are still local and under development, there is no strong case for an EU intervention. Yet, divergences among national regulatory frameworks and diverse interpretations of EU rules applying to crowd-funding activities could create obstacles to the development of cross-border business and may lead to market fragmentation. Furthermore, the need to comply with different requirements may be too costly and prevent smaller platforms from achieving the scale necessary to operate cross-border. Divergences in regulatory regimes may also pose challenges to cross-border investor protection. Therefore, the Commission services will continue to monitor market and regulatory developments and maintain a regular dialogue with regulators and the industry.

F) Harmonisation of insolvency frameworks

Stakeholders repeated concerns about the lack of harmonised insolvency frameworks in the EU. The emergence of a pan-European capital market would require more transparency and clarity as to the rules that apply in different jurisdictions in cases of insolvency. Greater clarity and more harmonised rules would allow investors to assess better the risks to their portfolios, and thus enhance their decision-making in particular as regards to cross-border investment. Concerns were raised at the general level, as well as with reference to specific markets, sectors or instruments.

As part of the CMU action plan, the Commission services are currently working on three work streams on different aspects of the pre-insolvency/insolvency system.

- First, the Commission will table a proposal for a minimum harmonisation Directive on business restructuring and second chance, key elements of an appropriate insolvency framework. The proposal will also include provisions establishing common reporting requirements regarding the outcome of restructuring and insolvency procedures, as well as some elements to enhance their efficiency.

- Second, the Commission services are setting up a benchmarking review of loan enforcement (including insolvency) regimes. This will provide a detailed comparison of outcomes that banks experience under the different national systems in terms of delays, costs and recovery value when managing defaulting loans.

- Third, the Commission is undertaking further harmonisation of the BRRD "creditor hierarchy" in bank resolution, as integral part of the Banking Union agenda.

G) Developing sustainable finance

Promoting sustainable finance is a key EU issue in the light of EU (and G20) commitments towards climate change and transformation to a low-carbon economy. Stakeholders called on the Commission to help shaping definitions, promote best practices and develop the market in sustainable finance (such as green bonds). While some provided strong support for setting standards and developing the green bond market through quality-labelled issuance, stakeholders did not see the need for legislative action at this stage.

The Commission supports alignment of private investments with climate, resource-efficiency and other environmental objectives, both through policy measures and public investment.

The Commission is working to increase the availability of green funds through the European Fund for Strategic Investment, by earmarking at least 20% of the EU 2014-2020 budget available for climate action, and by setting up a platform for financing the circular economy. Moreover, as highlighted in the CMU Action Plan, there is a need to support EU green bond standards. The Commission has established a high level expert group to develop a comprehensive European strategy on sustainable finance.

5.4. Technological developments

Against the background of rapid technological change, it is a permanent challenge to ensure that regulation remains fit for purpose; at the same time it is a central concern for policy makers that regulation is not impairing technological progress. Some respondents have raised concerns, albeit of a very general nature, that the current financial legislative framework does not take sufficiently account of new and emerging technologies. Also, the possibility that interplay between financial services legislation and other horizontal legislation could give rise to inconsistencies was raised. Other respondents have pointed to more specific issues. For example, some members of the banking industry have highlighted possible issues as regards the prudential and/or accounting treatment of investment in software. Many stakeholders stressed problems with distance identification and know your customer (KYC) requirements. Concerns were also raised regarding gaps, overlaps and inconsistencies in the field of cybersecurity

for financial services (e.g. triple notifications of breaches; need for a mechanism allowing better cooperation and information-sharing; importance of creating a framework for cyber security monitoring). Several submissions have referred to transformative technologies and business models in financial services. The stakeholders have referred, in particular, to the impact that distributed ledger technology (DLT) could have in the way clearing and settlement services operate, and that new regulation would have to consider any more widespread uses of DLT. Finally, respondents have asked the Commission to ensure a level-playing field between incumbent regulated entities and new market entrants (FinTechs).

A) Prudential and accounting treatment of investment in software

Certain stakeholders have claimed that the EU treatment of software as an intangible asset under IFRS would require European banks to deduct the software from their capital, whereas US banks would be allowed not to deduct. This would un-level the playing field and would provide disincentives for IT/software investment by banks. The stakeholders assumed that in the EU internally developed software is treated as intangible both for accounting and prudential purposes while in the US they are in practice treated as tangible and not deducted for prudential calculation.

In principle, software is, in accounting terms, treated as intangible assets. With regards to accounting principles, there are no meaningful differences in the recognition of software in US GAAP and IFRS. If software was considered to be immaterial in accounting terms however, the accounting provisions do not apply and assets may be aggregated with another category of fixed assets. The materiality principle applies in both accounting sets and is based on professional judgement. It seems that the same flexibility would be available to banks reporting both under US GAAP or IFRS. Under prudential requirements, intangible assets must be deducted from capital that counts toward regulatory capital requirements. The prudential rules rely on financial accounts and are consistent between EU and US. The software as intangible asset used for internal purposes is likely to have little market value. Therefore, to the extent the software is not considered an intangible asset accounting wise, which seems to be the case for some banks, this ultimately leads to different prudential treatment and could be a source of un-level playing field.

The Commission services will engage in a dialogue with stakeholders to gain a better understanding of the interaction between accounting and prudential treatment of software.

If clear evidence emerges that there is a difference in capital treatment of software between the EU and the US, the Commission services will consider the appropriate action to be taken in order to ensure a level playing field and strike the right balance between financial stability and promoting financial innovation.

B) Financial information and disclosure and digital technology

Stakeholders claim that requirements on disclosure, information, contracting, authorisation and reporting are not always well adapted to recent technological developments. Rules on the disclosure of (pre)contractual information should be technology-neutral, and as a result they should not require or discard a particular technological solution for making such information available. For example, the notion of 'durable medium' creates room for interpretation which can result in problems with national implementation. Moreover, stakeholders from the financial services industry have raised the issue that, consumers can become easily overloaded with information. Such information overload⁷² can be to the detriment of consumers' understanding and thus reduce the effectiveness of disclosure as consumer protection tool.

The relevant provisions on forms or carriers of disclosures/reporting enshrined in several pieces of legislation (e.g. PRIIPs, MiFID II, UCITS, PD, the Distance marketing of consumer financial services Directive⁷³ etc.) typically allow for a broad range of options. Relevant provisions prescribe the alternative or combined uses of paper, other durable media, or internet websites as possibilities for disclosing (pre)contractual information to consumers. In the end the choice of the preferred medium of disclosure is very much left to the consumer: the PRIIPs regulation prescribes the paper format by default in case of face-to-face distribution unless the consumer requests otherwise⁷⁴. The UCITS regulation provides that a key investor information document (KIID) can be provided on a "durable medium" (other than paper) or a website, if the consumer chooses so.⁷⁵

The notion of 'durable medium' which encompasses any medium that allows the recipient of the information to safeguard and (re-)produce an exact copy of the information/data that was provided for the duration of the contract and any time after that, as may be required for legal or regulatory requirements, was intended to provide flexibility. Efforts should focus on closing the remaining legal and technological gaps vis-à-vis the use of a durable medium to ensure an appropriate level of legal certainty about the substance of the contract, the identity of the contracting parties, the precise date of the exchange of

⁷² In the case where information and communication technologies (ICT) strongly reduce the production of (automated) information, ICT may very well favour an excessive provision of such information as it may be relatively cheaper to provide overlapping and duplicative information.

⁷³ Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC.

⁷⁴ Article 14 (2) of the Regulation (EU) No 1286/2014 (PRIIPs)

⁷⁵ Article 38 of the Commission regulation (EU) No 583/2010 implementing Directive 2009/65/EC (UCITS)

consent between the parties, and the duration of the validity of the contract. For example, fiduciary time stamps for documents provided on the internet remain, at this juncture, a topic of ongoing research.

In the context of the comprehensive assessment of European markets for retail investment products (including distribution channels and investment advice), the Commission services will investigate how the policy framework should evolve to benefit from the new possibilities offered by internet-based services or any other financial technology (FinTech). The same assessment will serve to identify ways to improve the policy framework and intermediation channels so that retail investors can access suitable products on cost-effective and fair terms.

C) Distance identification and Know Your Customer (KYC) requirements

Regulation equates face-to-face identification and/or identification based on official documents (such as national ID cards) with a more authentic and safer way to identify customers to the detriment of distance and other technology-based means of identification. In this context, respondents have pointed at inconsistencies between the Electronic identification for electronic transactions in the internal market (e-IDAS) Regulation⁷⁶ and anti-money laundering directive (AMLD4)⁷⁷. They have criticized that, while e-IDAS opens up new opportunities for business relations at a distance, these relationships are considered as high-risk transactions under AMLD4. At the same time, respondents have stressed that consumers increasingly expect to be able to carry out all kinds of financial transactions online using various forms of distance identification.

Stakeholders welcomed the Commission's work on the e-IDAS regulation and were positive about its high potential in the area of retail financial services, e.g., easier access to services at a distance and the verification of customer identity; however, e-ID is currently not available on a broad scale, and it focuses on public services. Respondents have suggested extending the digital framework for national e-IDs valid across the EU to enable their use in the private sector, i.e. to allow customers to identify themselves and sign up for services in other Member States by using their national e-ID.

⁷⁶ Regulation (EU) No 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market and repealing Directive 1999/93/EC.

⁷⁷ Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC.

To address the above concern, the Commission proposed on 5 July 2016, that the AMLD4 should be updated to take account of the new legal framework on the mutual recognition of notified e-ID schemes and means, to eliminate any potential incompatibilities between the legal texts. In view of this, the Commission proposed that references to electronic means of identifications set out by the e-IDAS Regulation should be included in Article 13(1), Article 27(2), Article 40(1)(a) and (b) as well as in Annex III to the 4AMLD.

Moreover, the follow-up work to the Retail Financial Services Green Paper will also explore solutions to encourage remote ID recognition and signature of contract.

D) Cyber-security for financial services

Many respondents have noticed some inconsistencies and gaps in the field of cybersecurity. Some have pointed to provisions in the General Data Protection Regulation (GDPR)⁷⁸ that could constitute real obstacles for building and developing efficient cybersecurity regime(s) in Europe and internationally. For example, it is not possible to share information about cyber-attacks that may involve customer data or other data such as IP addresses (which are considered personal data). A further issue raised concerned the need of a regulatory assessment of the potential IT/cyber incidents and risks. In this context a wide range of stakeholders stressed that legislative acts (NIS/PSD/GDPR) impose on financial institutions obligations to report security breaches to three different authorities causing undue burdens without any benefits in terms of security.

In order to fight against global cyber threats, a way forward could be to put in place mechanisms that allow for cooperation and information-sharing for cybersecurity purposes. As regards the incident notification process, it seems straightforward that it should be consistent, simple and effective.

The Commission services will exchange views with stakeholders on how to share information on cyber threats.

E) Level-playing field between incumbent financial institutions and new market entrants (FinTechs)⁷⁹

⁷⁸ Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation)

⁷⁹ Including models based on digital currencies, or digital assets derived from digital currencies.

Financial institutions asserted that services they provide are subject to prudential, market and other types of regulations, whereas new market entrants or alternative providers offering comparable services are not subject to the same regulations, which could undermine the level-playing field. At the same time respondents expressed the view that technology in this area is progressing at a rapid pace. As a result, premature regulation could run the risk of stifling innovation (not being technology neutral) given the differences in speed between technological and legislative innovations.

At this stage it is difficult to make an overall assessment on whether digitalisation and the arrival of new services, business models or market entrants undermine the level-playing field, given the diversity and novelty of some business models and the rapid development of new market entrants, as well as the uncertainty about the viability of such business models. There are clear advantages associated with being a regulated financial institution, such as access to central bank liquidity and deposit guarantees. Accordingly, level-playing field arguments must be looked at in a holistic way. The nature of the entity and the risk of its business, including its size and interconnectedness, may also determine the set of applicable rules. Finally, a choice has to be made between a 'same risk, same regulation/different risk, different regulation' approach and a 'same activity – same regulation' approach.

Work on this subject is ongoing at the ECB, the ESAs (EBA, ESMA), other public institutions in Member States, as well as in private sector and academia. The Commission services have also set up a Task Force to look into digital innovations with implications for financial products and services. An international conference on financial technology will be organized by the Task Force in the first half of 2017. The Commission services also contribute to the on-going work within the Fintech/DLT Task Force established by Committee on Payments and Market Infrastructures- International Organization of Securities Commissions "CPMI-IOSCO".

Annex 1: Acronyms

AD	Accounting Directive
ADR	Alternative dispute resolution
AIF	Alternative investment fund
AIFMD	Alternative Investment Fund Managers Directive
AMLD	Anti-money Laundering Directive
ASF	Available stable funding
AT1	Additional Tier 1
BCBS	Basel Committee on Banking Supervision
BIS	Bank of International Settlements
BRRD	Bank recovery and resolution Directive
BSR	Bank Structural Reform
CCD	Consumer Credit Directive
CCPs	Central counterparty clearing houses
CCyB	Countercyclical capital buffer
CLOs	Collateralised loan obligations
CEAOB	Committee of European Auditing Oversight Bodies
CEM	Current exposure method
CMBS	Commercial mortgage-backed securities
CMU	Capital Markets Union
COM	European Commission
CPMI	Committee on Payments and Market Infrastructures
CRA	Credit rating agency
CRR /CRD IV	Capital Requirements Regulation/Directive
CSDR	Central Securities Depositories Regulation
DG JUST	European Commission Directorate-General for Justice and Consumers
DGSD	Deposit Guarantee Scheme Directive
DLT	Distributed ledger technology
DVC	Double volume cap mechanism
EBA	European Banking Authority
ECAI	External credit assessment institutions
ECB	European Central Bank

EDIS	European Deposit Insurance Scheme
e-IDAS	Electronic identification for electronic transactions in the internal market
EIOPA	European Insurance and Occupational Pensions Authority
ELTIF	European long-term Investment Fund
EMIR	Regulation on OTC derivatives, central counterparties and trade repositories
EPTF	European Post Trading Forum
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EuSEF	European Social Entrepreneurship Funds
EuVECA	European Venture Capital Fund
FICOD	Financial Conglomerates Directive
Fintech	Financial technology
FMI	Financial market infrastructure
FSB	Financial Stability Board
FTT	Financial Transaction Tax
FRTB	Fundamental Review of the Trading Book
GDPR	General Data Protection Regulation
GHOS	Group of Central Bank Governors and Heads of Supervision
G-SIB	Global systemically important bank
G-SII	Global systemically important institution
HQLA	High quality liquid assets
IASB	International Accounting Standards Board
IDD	Insurance Distribution Directive
IFRS	International Financial Reporting Standards
IM	Initial margin
IMD	Insurance Mediation Directive
IMF	International Monetary Fund
IPS	Institutional Protection Scheme
IORP	Institutions of Occupational Retirement Pensions
IOSCO	International Organization of Securities Commissions
IRB	Internal ratings-based

IT	Information technology
KID	Key information document
KIID	Key investor information document
KYC	Know your customer
LCR	Liquidity coverage ratio
LR	Leverage ratio
MAD/R	Market Abuse Regulation and Criminal Sanctions Directive
MCD	Mortgage Credit Directive
MDA	Maximum distributable amount
MiFID II/R	Markets in Financial Instruments Directive and Regulation
MMF	Money Market Fund
MREL	Minimum requirement for own funds and eligible liabilities
MS	Member State
MTF	Multilateral trading facility
NAV	Net asset value
NCA	National competent authority
NCWO	No-creditor-worse-off
NFC	Non-financial corporation
NIS	Network and information system
NPL	Non-performing loan
NSFR	Net stable funding ratio
OAM	Official appointed mechanism
OTC	Over-the-counter
O-SII	Other systemically important institution
PAD	Payments Account Directive
PD	Prospectus Directive
PIE	Public-interest entity
PRIIPs	Packaged retail and insurance-based investment products
PSD	Payment Services Directive
REFIT	Regulatory Fitness and Performance Programme
REMIT	Regulation on wholesale energy market integrity and transparency
RSF	Required stable funding
RTS	Regulatory technical standards

SA	Standardised Approach
SF	Supporting factor
SFTR	Securities Financing Transactions Regulation
SMEs	Small and medium-sized enterprises
SRB	Single Resolution Board
SSM	Single Supervisory Mechanism
SSR	Short Selling Regulation
STS	Standardised and transparent securitisation
TD	Transparency Directive
TLAC	Total loss-absorbing capacity
UCITS	Undertakings for collective investment in transferable securities
VM	Variation margin

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