EIFR European Institute of Financial Regulation

Preview on the upcoming report on the Call for evidence

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Why the call for evidence (CFE) ?

- Before the 2007-08 crisis, trust was not an issue in financial markets or for European authorities, which were more focused on such topics as competition within Europe than on financial stability. When it appeared that financial risks had been distributed to people or entities who even did not know about holding those exposures, trust in financial markets - and in the institutions - suddenly vanished: then emerged this new definition of financial stability crisis which is when people loose trust in the capacity of authorities to manage the crisis. European institutions have thus been overly busy with crisis management since 2007, striving to restore confidence in finance and Europe.
- After a 5 year wave macro & micro measures with over 40 pieces of legislation and 400 pieces of secondary legislation in banking, securities, accounting …, it was considered useful to develop a kind of maintenance tool to identify what could work better in regulation and address weaknesses with the determined objective of a smart regulation. The European Commission (EC) recognised that, after all this legislation was passed, it was unlikely all the proposed changes were made for the better. The EC was thus of the view that it made sense to undergo a « fitness test » which did not suggest a « change of approach », or worst, « deregulation ». It was a call for the industry to bring some evidence in areas where legislation could be improved.
- Opened on September 30, 2015, the CFE "*was designed as a public consultation in which the Commission invited all interested parties to provide feedback on the benefits, unintended effects, consistency and coherence of the financial legislation adopted in response to the financial crisis*" [1]
- It was actually feared by some that the CFE would inaugurate a phase of deregulation, or that there could be some loosening or trade-off between stability and growth: the exercise was welcome with some suspicions, with some arguing that policymakers were engaging in a process aiming at «reversing » or « rewinding » legislation. The EC insists it is not the case and warns against possible trade-offs even if this means producing a financial system which is less competitive than peers (such as that of the US).
- There is indeed no fundamental change in approach, and the need for a comprehensive regulatory framework is fully reaffirmed. Regulation is obviously part of trust, which in turn is a condition for investment and growth. What is new in the CFE is the bottom up approach based on evidence to ensure consistent, coherent, stability-oriented but forward looking regulation.
- All interested parties had the opportunity to submit their contributions by January 30, 2016. A public hearing on the CFE was organised on May 17, 2016 in Brussels. This was an opportunity for stakeholders to further substantiate their respective submissions and to discuss the initial results of the consultation.
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[1] **EUROPEAN COMMISSION [2015]**, « Call for Evidence: European Regulatory Framework for Financial Services », *Frequently Asked Questions*, September 30

- The EC admits the UK referendum on membership with the European Union has caused some delay (with the departure of Lord Hill, EU Commissioner for Financial Stability, Financial Services and Capital Markets Union) in processing with the data from incoming responses (some 300 were received).
- The main findings are to be officially published in November.

Summary of key findings

- The EC insists four themes were dominant in the consultation:
  - A call was made to be wary of the flows of finance in the economy. In particular, the industry insisted on the need to protect financial flows as a key driver of economic growth in order, in particular, not to conflict with the agenda of the EU Juncker plan.
  - The second theme is the need to enhance proportionality in the system. This is also part of the broader need to strike a sound balance between financial stability and growth. The demand was for rules not to carry unnecessary burden on the financial system. For the time being, a single rulebook was designed for much diversified groups and activities. The idea is for regulators to favour a « proportionate » application of the rulebook.
  - The third theme is not to impose unnecessary regulatory (reporting and supervisory) burden. Regulations should aim at complying with targets at minimum (compliance) costs. The industry insisted not only on duplications but, more strikingly, on inconsistent reporting requirements originating from banking and market supervisors.
  - The last theme which emerged from the consultation was not just for rules to be more consistent across sectors but also for rules to be « forward looking ». It would make, according to stakeholders, sense for some legislation, undertaken in parallel, to be « cross-checked ». Participants also insisted that, for the legislation to be anticipatory, rules needed to be « technology-neutral ».
- On unintended consequences, the EC makes the case that these are of two types: (i) the unintended consequences which are unjustified and, by that, should be corrected; (ii) others which are there to stay. For instance, the EC notes how much market liquidity is very often, if not always, put forward as an unintended consequence of new regulation. On the subject of market liquidity, the EC considers that de-risking the balance sheets of banks made it more expensive for them to warehouse illiquid securities. This has had some consequences on the capacity of banks to act as market makers in the capital market activities. The EC recognises this is an unintended consequence. Yet, the EC opines that if remedying to this situation means re-risking the balance sheet of banks, then this option will not be retained. Other means to manage liquidity in the market will have to be explored.

Conclusion

- The EC is of the view that the CFE is a very useful exercise, and a further illustration of evidence-based policymaking.
- The CFE will not be used in a « stand-alone » approach. On the contrary, the objective is for the main findings to actually feed all the regulation which is currently been built or reviewed.
- The EC is also keen on using the CFE in international forums. At first, as previously mentioned, the exercise was welcome with suspicions. Now, it is considered mostly « mainstream» with similar consultations envisaged or already undertaken at the level of the Financial Stability Board or the Basel Committee.
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- Yet, the EC recognises that the CFE should not be viewed as a replacement of a cumulative impact assessment even if such analysis is very difficult to be effectively implemented.
- Future CFEs would have focus more on «quantification» which should be a reasonable objective at that point as legislation would have been in place for a longer period of time (more evidence would be available).

Questions and comments

- Comment about the lack of strategy and methodology from the financial industry: there has not been enough common industry public thinking about the desirable model for the financial sector on terms such as the balance between banks and capital markets, …; regulation should be implemented once considering the definition of a global industry strategy.
- Comment on a question of method on the European autorities'side as well, as illustrated by securitisation: European authorities should rely more on industry experts; banks, which have no request except be in a position to create space on their balance sheet to accompany European growth, can explain what is technically and mechanically feasible to have the securitisation market work again.
- Question about the return to new normal after the illusion of liquidity through Quantitative Easing finishes: it is not easy to define new normality; what should be considered is what is needed for decent functionning of markets; regulation is clearly not the only factor; action relies more on ECB; still, QE exit is an issue and cannot be but quite progressive.
- Question on attention to competitiveness the EC should have when regulating: the market share of the European funds industry has been declining steadily for 10 years vs US and Asian competitors (15 US players in the top 20 asset managers worldwide): the EC accepts that the impact of regulation on competition has to be furteher considered.
- Question on progress on PRIIPs after objection by the European Parliament and likely impact on implementation calendar: it is necessary to better understand the Parliament's position with some concern about reopening the whole subject with many institutions involved (RTS outsourced to ESAs).
- Other questions on the benchmark regulation, the debt-equity fiscal bias, the outcome of the CFE for the insurance sector, and liquidity.

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