German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

Capital Markets Union Mid-term Review

2017

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The German Banking Industry Committee, which represents approximately 1,700 banks in Germany, welcomes in principle the Commission's intention to update and complete the Action Plan on Building a Capital Markets Union.

GENERAL REMARKS

The targeted identification of a need for improvement seems hardly possible at the present time, as the underlying initiatives for a Capital Markets Union have either not yet been implemented or have entered into force. Consequently, their interactions and actual effects in the market are currently not assessable.

We recommend a review of the existing regulation of the capital market as part of the introduction of future rules and regulations. The objective should be a set of regulations "all of a piece", which avoids double regulation and inconsistencies (to the extent possible), and takes into account the cross-dependencies of financial market regulation. Regarding regulation, it remains highly important to strike the right balance between stability, investor protection, and performance of the financial markets.

One example of an area where the single rulebook has yet to become a reality is the disclosure regime for issuers who wish to tap the capital markets. The requirements, which currently apply at European level, are not adequately coordinated with one another. As a result, they impose an excessive burden on issuers while offering investors little added value. Take, for instance, the various disclosure requirements under the First Company Law Directive (68/151/EEC, now 2009/101/EU), the Prospectus Directive (2003/71/EU), the Transparency Directive (2001/34/EU), the Market Abuse Regulation (596/2014) and the PRIIPs Regulation (1286/2014). Harmonization across these directives and regulations is long overdue so that duplication and overlaps are eliminated and an appropriate level of investor protection can be established. Further details we set out in our comments relating to the revision of the Prospectus Directive.

Another example is the cost transparency disclosure rules under MiFID II and PRIIPs. Thus, for example, the requirements for disclosing costs under MiFID II and PRIIPs are not harmonised. In many cases MiFID II regulations (Art. 25 (4) MiFID II, Art. 50 f. MiFID II DA) require distributors to inform their customers of costs inherent in the product. These costs are normally known only to the issuers, so that the distributors are unable to ascertain the costs inherent in the product or only with considerable effort. This appears to be unreasonable, not least because investors also receive information about these costs through the PRIIPs KIDs. A coherent regulation would have avoided this duplication of data on product costs. At the very least, however, it should have been ensured that any "double" cost information from the manufacturer / issuer and the distributor should be measured according to the same principles. This is also not the case with MiFID II and PRIIPs. Instead, cost calculation methods for PRIIPs and MiFID II can lead to different results. In fact, congruence could have been achieved without any great effort: for example by means of an opening clause allowing the standard addresses as an additional option to use the cost calculation method according to PRIIPs under MiFID II too. This should be taken into consideration for the future.

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The desire for a self-contained financial market regulation also includes a timing factor. Thus adequate and legally effective implementation periods should ensure in future that the legislative acts of the different stages are coordinated with each other and that there is still sufficient time to implement the new regulations punctually. Unfortunately, two recent examples show that this is not always the case. Both MiFID II and the PRIIPs Regulation are supplemented by comprehensive Level II measures. In the absence of knowledge of the specific characteristics of Level II or III, implementation cannot take place. Both legislative projects failed to adhere to the timetable envisaged, which led to considerable legal uncertainty and significant additional costs. In order to avoid this in future and to ensure that Level II can be adopted without time pressure, the implementation deadlines for the institutes should be based on the enactment of Level II (applicability of the guidelines e.g. nine months after publication in the Official Journal of the EU).

Another objective should be the identification and reduction of excessive formalism in the interests of investor protection. As important as investor protection is, excessive formalism will potentially discourage investors and encourage banks and savings banks to withdraw from their role as mediators due to cost and liability risks. Today, excessive regulation is already leading to the withdrawal of retail clients from capital market investments. Consequently, many retail investors refrain from using the support provided by investment advice, and thus potentially miss important opportunities on the capital market.

We have already set forth further examples and considerations on the EU Commission’s "Creation of a Capital Markets Union" Green Paper in our comments dated 13 May 2015, to which we refer at this point.

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

We welcome the Commission's support for market initiatives in the field of private placements and that corresponding financing instruments for companies are not to be encumbered by new regulations.

Private placement is and continues to be an investible asset class. But while some investors like big insurers may be able to absorb the capital charges more easily than others (for example, institutional investors with smaller portfolios or inventory, or those for whom private placement is a new asset class), GBIC considers, as a new proposal, that lowering current Solvency II charges may incentivize more investment. The calibrations for capital charges currently focus on volatility risk. For buy-to-hold investors, such as insurers acquiring private placement to match their long-term liabilities, the impact of market volatility is immaterial as the assets are intended to be held to maturity and therefore the correct metric for calibrating capital charges should instead be default risk. Default rates are lower, and recovery rates higher, on private placement than for comparable corporate transactions, with comparability being based on implied ratings. This may also affect the level at which the capital charges are ultimately set. GBIC therefore welcomes the commitment announced by the Commission to assess the prudential treatment of privately placed debt in Solvency II.

In many cases, the financing of innovation projects is largely made from the innovator’s own resources. If these are insufficient, external sources of financing are, above all, bank loans and participation capital, including public subsidies. Unlike "normal" investment financing, with innovation financing the success of the business project is often uncertain and fraught with major economic and technical risks. Added to this is the fact that innovative projects offer hardly any collateral possibilities for classic loan financing. In

view of the high risks, the assessment of the technical feasibility and marketability of the innovation projects is of decisive importance.

Depending on the intended purpose and duration, bank loans incorporating public subsidies are particularly suitable for financing promising start-ups. By improving the tax framework for venture capital, this form of financing could become even more important for founders too.

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

Regarding the draft Prospectus Regulation, it may be noted that agreement between the European institutions on the content of the legal text was comparatively fast. This is to be welcomed in principle. However, the rapid process has resulted in a large number of substantive provisions not being made in the Prospectus Regulation itself and they will now have to be worked out at Level II. We consider this approach dubious in view of the likelihood that a great deal of time will have to be invested in detailed work on the Level II texts and that the Prospectus Regulation will take effect without regard for the actual progress of work on the Level II texts. Here we see a danger that delay in this work could lead to problems comparable to those with PRIIPs and MiFID II.

Suggestion for improvement:

We consider it to be preferable from the "good governance" point of view if the legal practitioners of a Regulation can already gather as much content-related regulation from the Level I text as possible, rather than from a large number of ancillary Level II texts.

3. INVESTING FOR LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT

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

4. FOSTERING RETAIL INVESTMENT AND INNOVATION

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

Furthermore, any proposals made should be subject to a comprehensive impact assessment and only be taken into account if the assessment indicates that a positive net effect is to be expected.

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We understand the idea of further market-opening, since greater cross-border supply can, in principle, increase competition in national markets. The German market for financial services is already highly competitive, however, with a broad range of products on offer at low prices. It can therefore be assumed that an increase in cross-border supply would not strengthen the already keen competition in Germany.

As indicated above, the European Commission should first pursue its own better-regulation approach, before considering proposals for new regulatory measures. It is essential, when considering any regulatory measure, to weigh the time and cost of implementation – which any form of regulation inevitably involves – against the additional benefit it will deliver. It is important when considering any regulation to respect the principle of proportionality so as to avoid excessive regulatory burdens having structural policy ramifications – especially for small and medium-sized banks.

In particular, all regulatory considerations should weigh the extent to which the effort of implementation – which any form of regulatory measures involve – is commensurate with the additional benefit.

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

Furthermore, barriers are caused not by problems such as a lack of digitization and innovation in the financial sector but by the lack of an adequate legal framework for offering services across borders. There is, for example, no recognised EU-wide procedure for verifying the identity of customers from another member state who wish to open an account.
Established banks are also investing in the digitization and innovation of financial products and there are many cases of cooperation and collaboration between banks and fintecs. In the interests of a level playing field, it is important that banks and fintecs are subject to the same regulatory requirements, especially where fintecs offer financial products and services independently. Otherwise, competition will be distorted, leading to a negative impact on consumer protection.

Over-regulation should be avoided. Thus each bank should be free to decide, in its responsibility for its own business policy, which innovations will be promoted in order to retain a broad freedom to develop and offer innovative solutions.

5. STRENGTHENING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY

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

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

We welcome the initiative to create an STS-regulation to foster the European securitisation market. Nevertheless, as the European co-legislators have now each approved their own version of the initiative and the trilogue has started, we have some concerns that the proposals might even harm the European securitisation market. Even though European securitisations performed very well during the financial crisis and even though the STS-label is for simple, transparent and standardized securitisations, the risk weights, the floor and maybe also the risk retention rates will be increased significantly, for STS securitisation less than for non-STS. The combination of those increases will hinder the securitisation market. Furthermore, the STS-label as proposed, will lead to major uncertainty. There are too many ambiguous criteria that have to be fulfilled to be STS and there is no authority, that will confirm in advance whether a securitisation is eligible for STS or not. Therefore, an originator using the STS-label is in danger that his or her assessment of a criterion is wrong due to the ambiguity, which even could result in sanctions and withdrawal of the STS-label after issuance. This would not only damage the reputation of the originator, but also the STS-label itself. Therefore, the originator should at least obtain the right to request from the competent authority a confirmation based on an own assessment that the securitisation complies with the requested criteria. This would only be a confirmation with regard to the requested STS-criteria, but no certification of STS-compliance of the securitisation. It would contribute to significantly increasing the level of certainty for originators. We also have concerns, that the exclusion of some institutional investors and the burdens on investors will shrink the European securitisation market. Professional clients (pursuant to MIFID II) should not be excluded as investors. In addition, there should be no public disclosure of data about investors, as it will dissuade them to invest and might conflict with data protection laws. With Brexit in mind, we kindly ask not to be more burdensome than international standards, as the UK is an important player in securitisation and might attract European business, if it will not implement an equivalent to the European regulation after Brexit.

6. FACILITATING CROSS-BORDER INVESTMENT

Regarding the legislative initiative on business insolvency: Commission proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures:

In our opinion, a harmonization of substantive insolvency law cannot make a significant contribution to the creation of a pan-European capital market. It is true that the issuer risk must also be taken into account when making an investment decision. The basis for this evaluation is, however, primarily the solvency of the issuer and at best subordinately the applicable insolvency law. We are also sceptical about the EU-wide harmonization of pre-insolvency restructuring procedures for companies in the form presently proposed by the European Commission. The regulations envisaged by the draft directive lack balance and burden creditors to an unreasonable extent, in particular secured creditors. The effects on lending business, and in particular on the granting of new loans, are significant.

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