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European Union Committee

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# The post-crisis EU financial regulatory framework: do the pieces fit?

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Q in footnotes refers to a question in oral evidence

## EXECUTIVE SUMMARY

The post-2008 financial crisis was the most severe in living memory, and its effect is still being felt today. The ramifications for the EU have been particularly acute. Its response, encapsulated in a set of some 40 legislative proposals, has brought about a radical transformation in the EU financial sector regulatory framework.

EU institutions, notably the Commission, the European Parliament, the Council of the European Union and the European Council, were placed under considerable strain by these events. Given the magnitude of the task they faced in responding to a once-in-a-generation crisis, we conclude that the institutions have all performed well.

Nonetheless, the sheer scale of the reforms means that the financial sector regulatory framework inevitably contains some weaknesses. In particular, the expected high standards of consultation and impact assessments were not always maintained. Yet this should not detract from the significant achievement that the reformed framework represents.

One of the key planks of the new framework was the establishment of the new European Supervisory Agencies (ESAs). These bodies have endured a baptism of fire since their inception in 2011 and have been responsible for much good work. Yet they are hampered by several fundamental weaknesses, including a lack of authority, insufficient independence, marginal influence over the shape of primary legislation, insufficient flexibility in the correction of legislative errors, and inadequate funding and resources. The powers and authority of these agencies need to be enhanced.

We note that the most flawed of the legislative reforms were the result of political pressures to take prompt action, and/or to make the financial sector pay for the crisis. Prime cases include the Alternative Investment Fund Managers Directive (AIFMD), the bank remuneration provisions in the Capital Requirements Directive (CRD IV), and the contentious plans for a Financial Transaction Tax. Yet these are exceptions. We find that the bulk of the new regulatory framework was necessary and proportionate, and would have been implemented by the UK even if action had not been taken at EU level. We also find that it was highly desirable that regulation should be produced for the EU as a whole, both to strengthen the Single Market and to avoid regulatory arbitrage.

That said, it was perhaps inevitable, given the amount of new legislation, its broad range and the speed of its introduction, that there would be a number of inconsistencies, rough edges and elements which, with the benefit of hindsight, were disproportionate or even misguided. Not enough consideration was given to the overall effect on the financial sector of such a huge programme of reform, or to ensure consistency with international regulation.

We therefore welcome the commitment of the new European Commissioner for Financial Stability, Financial Services and Capital Markets Union, Lord Hill of Oareford, to review the cumulative effect of the various reforms. Such a review should include a thoroughgoing internal audit of the entire legislative framework to date, with a view to making recommendations to remedy the key weaknesses that are identified.

A further oversight was the belated recognition of the importance of the growth agenda. We therefore welcome the Commission's recent proposals for an Investment Plan for Europe and for a Capital Markets Union. Yet the responsibility for promoting growth and prosperity lies not only with the Commission and the EU institutions but with every Member State.

The UK has the largest financial sector in the EU, and the implications of these reforms for this country are therefore immense. We believe and regret that the UK's influence over the EU financial services agenda continues to diminish. The UK Government and other UK authorities must take urgent steps to correct this, and to enhance the UK's engagement with our European partners. This Committee will seek to play our own part in our liaison with the EU institutions. A united effort is needed to convey the message that the prosperity of the City of London, and the financial services industry it hosts, is in the interests not only of the UK but of the EU as a whole.

## LIST OF CONCLUSIONS AND RECOMMENDATIONS

In the following list, recommendations are denoted by an asterisk and recommendation number.

### The role of the EU institutions

1. We acknowledge the daunting and unenviable task that the Commission faced in responding to a once-in-a-generation crisis. In that context, the sheer output and workrate of the Commission is to be admired. Unsurprisingly, the scale of the crisis placed the Commission under intense strain, not least in terms of stretched resources. As a result, the expected high standards of consultation and impact assessments were not always maintained. The Commission should also have focused more on the overall impact rather than the quantity of its legislative output. Yet this should not detract from the credit due to the Commission for its diligence in designing a legislative response to the worst financial crisis in living memory. (Paragraph 42)

2. We welcome the new Commission's efforts to promote Better Regulation, led by First Vice-President Frans Timmermans. A key component of Better Regulation should be to ensure that a full assessment is undertaken of the impact of substantive amendments to legislation made during the negotiating process. While the Council and Parliament are primarily responsible for post-proposal changes, we urge the Commission to take the lead in ensuring effective impact assessment of major revisions is carried out. A mechanism for the swift reallocation of resources within the Commission to where it is most needed at a time of crisis also needs to be put in place. (Paragraph 43) (* Recommendation 1)

3. The European Parliament has played an equally diligent role in its scrutiny of all aspects of the EU financial sector regulatory framework. We particularly acknowledge the way in which its Economic and Monetary Affairs Committee (ECON) Committee has developed expertise in this policy area. Nevertheless the Parliament has been prone to occasional popular (and populist) reforms that have not stood up to scrutiny. It has also faced resource constraints in responding to a legislative framework of such magnitude. The sheer volume and scope of pending Level 2 measures means that such constraints are unlikely to ease in the near future. We also reiterate that national parliaments and the European Parliament have a vital, and complementary, role to play in the European Union, and that there is scope for them to engage more effectively with each other. (Paragraph 50)

4. The Council of the European Union performs a vital function in ensuring that the views of Member State governments are taken into account. This is particularly important in the case of the financial sector regulatory framework, given the scale of the crisis, the volume of the legislation proposed, and the diverse nature of financial systems across the 28 Member States. It was understandable that the Council became a forum for compromise in negotiations on legislative proposals. Yet the Council and its members must retain their focus on the broad effects of regulatory reform on the EU as well as on narrow national self-interest. (Paragraph 54)

5. The European Council has played a pivotal role in co-ordinating the response of Member States to the crisis. It has also fulfilled an important agenda-setting function. It remains to be seen if this was a reflection of the personal skills and economic expertise of the former President, Herman Van Rompuy, or whether a prominent role for the President of the European Council will become a permanent feature of the institutional landscape. (Paragraph 59)

### The role of the European Supervisory Authorities (ESAs)

6. The three European Supervisory Authorities have endured a baptism of fire since their inception in 2011. They have been responsible for much good work in responding to the challenges of the crisis and the substantial legislative reform programme that has ensued, in particular in upholding the Single Market in financial services and developing the single rulebook. Nevertheless they are hampered by a number of fundamental weaknesses:

- A discernible lack of authority *vis-à-vis* the other EU institutions, the ECB, and national competent authorities such as the FCA and PRA;
- Insufficient independence from the Commission;
- Marginal influence over the Level 1 legislative process;
- An inadequate funding structure;
- A significant lack of resources given the scale of the tasks they have been asked to perform;
- Inadequate resources to fulfil effectively their consumer protection obligations;
- Insufficient time to ensure effective and wide-ranging consultation in relation to their Level 2 responsibilities;
- Insufficient flexibility in the application of legislation and in the correction of legislative errors. Such inflexibility seriously undermines the effectiveness of the legislative framework. Given the scale and complexity of the reforms, the time pressure under which they were adopted, and the rate at which markets develop, an efficient and flexible means for the correction of errors and the finessing of rules is of critical importance. (Paragraph 95)

7. We welcome the Commission's report on the ESAs, and its recognition of the need for short-term and medium-term improvements in their function. While we do not necessarily endorse all of its proposals, we call on the Commission to take forward as a priority its programme of reforms. In particular, we believe that there is a strong case for:

- Enhancing the ESAs' input and provision of technical support and expertise in the Level 1 discussions. As a starting point the Commission should, as a matter of practice, seek a formal opinion from the ESAs on its Level 1 proposals. Such input would provide a means to improve legislative proposals and to ensure that the ESAs were able to

understand the intentions that lay behind them. We see no good reason why the ESAs should be excluded from Level 1 discussions;

- Enhancing the ESAs' involvement in the development of Commission Impact Assessments, and requiring the ESAs to provide *ex post* assessments of the extent to which legislation meets its regulatory objectives;

- Increased resources devoted to fulfilment of the ESAs' consumer protection objective;

- In the medium term, development of a new funding mechanism via the financial industry, which will in turn help finance a significant increase in staff resources for the three ESAs. In the short term, the inclusion of ESA funding as a separate line in the EU Budget in order to underline the autonomy of the ESAs. (Paragraph 96) (* Recommendation 2)

8. We also call for the development of a more flexible expedited mechanism whereby the ESAs can, subject to appropriate scrutiny and accountability mechanisms, propose technical amendments to legislative texts to take account of technological developments or to correct errors. One such mechanism could be to give the ESAs the formal right and obligation to write to the Commission, copied to the Council and the European Parliament, pointing out any legislative defects or errors, and the textual amendments that they would wish to be fast-tracked to correct such defects. (Paragraph 97) (* Recommendation 3)

9. A number of simple reforms will help the Level 2 process more generally, including ensuring that the ESAs are allowed at least 12 months to complete their Level 2 responsibilities, with flexible rather than fixed implementation deadlines set out in the Level 1 text, in turn providing sufficient time for consultation with practitioners and regulators on the detail of Level 2 measures. It is also essential that an effective mechanism is put in place which, subject to appropriate accountability mechanisms, facilitates the making of technical amendments to complex Level 2 rules in as prompt a fashion as possible. (Paragraph 98) (* Recommendation 4)

10. The ESAs also have a role to play in strengthening their own effectiveness. We encourage the ESAs to enhance their consultation procedures and their engagement with smaller, less well-funded and less visible sectors and industry groupings, including, but not limited to, consumer groups. (Paragraph 99) (* Recommendation 5)

## The EU financial regulatory framework in context

11. Although it is recognised that issuance of bail-inable debt may raise the cost of funding for some institutions, the removal of an explicit bail-out guarantee that eliminates moral hazard should lead to greater market discipline. Furthermore, the expected short-term bank funding costs could be offset by a reduction of bank risk and may therefore lower the cost of bank funding in the future. (Paragraph 109)

12. We welcome efforts to improve the stability and resilience of the financial sector. We note in particular the Capital Requirements Directive, Capital Requirements Regulation and the Bank Recovery and Resolution Directive,

which are designed to reduce and mitigate the effects of the failure of a financial institution. Yet such reforms are only able to contain risk rather than eliminate it. (Paragraph 110)

13. We are also concerned that reforms designed to solve the problem of 'too-big-to-fail' have still not been sufficiently addressed. We are only now witnessing the early fruits of international discussions on this issue. In the meantime, the regulatory framework continues to leave taxpayers at risk of the failure of a large and complex financial institution. (Paragraph 111)

14. More needs to be done to enhance the transparency and comparability of financial assets to allow international, European and national competent authorities properly to regulate and supervise financial institutions, providing confidence to financial market participants and end users. The EU and global partners must remain alert to maintaining the resilience of the financial system to new and emerging risks. To that end we welcome the work of the Financial Stability Board in seeking to tackle the 'too-big-to-fail' dilemma. (Paragraph 112) (* Recommendation 6)

15. A lack of understanding of the complexity of the financial sector and its interconnections was a key factor in the scale and depth of the financial crisis. The EU's efforts to promote transparency across the financial sector as a whole are therefore welcome. Having said that, it is important to acknowledge the markedly different characteristics of each sector of the market when applying transparency requirements. A flexible approach is needed to ensure that the right balance is struck between reaping the benefits of increased transparency and ensuring that the market is able to operate in an effective and efficient manner. (Paragraph 119) (* Recommendation 7)

16. We welcome the reforms that have been introduced to strengthen consumer protection. Nevertheless, there are some flaws in the design of the new consumer protection tools, rendering them less effective. Excessively detailed disclosure requirements are unlikely to benefit consumers. Bans on inducements need to be tightly defined so that it is not possible to circumvent the rules. The trade-off between choice and protection which is implicit in the reforms must also be acknowledged. The impact of the new rules on the retail market should accordingly be carefully monitored by national regulators and the ESAs. (Paragraph 129) (* Recommendation 8)

17. We welcome the enhanced protection for consumer deposits in the event of a bank failure contained in the Bank Recovery and Resolution Directive. Yet we repeat that such risks can only be contained rather than eliminated. It remains to be seen how effective such protection will prove to be in the event of a further systemic crisis in the banking sector. (Paragraph 130)

18. We acknowledge the concern of a number of witnesses that internal inconsistencies and gaps are a troubling feature of the single rulebook. Given the complexity and reach of financial regulation, we also acknowledge that some internal inconsistency may be unavoidable. But where inconsistency and incomplete coverage becomes a risk to the Single Market, remedies must be found. (Paragraph 137)

19. We call on the Commission to undertake a detailed audit of the most serious inconsistencies and gaps within the single rulebook, and to take steps to remove any inconsistencies that create a risk of regulatory arbitrage or significantly

increase cross-border transaction costs. We also encourage the ESAs in their supervisory work to continue to be mindful of the need to identify unnecessary or damaging inconsistencies. (Paragraph 138) (* Recommendation 9)

20. New regulatory rules need to be consistently implemented and enforced across all Member States if the single rulebook is to be effective and the Single Market is to operate efficiently. We urge the Commission to step up its efforts to make full use of its enforcement powers. (Paragraph 146) (* Recommendation 10)

21. There is a trade-off between ensuring complete consistency across the Single Market in the form of the single rulebook and ensuring that the specific characteristics of the markets of individual Member States are taken into account. In saying that, it is essential that discrepancies in implementation are contained so as to protect the Single Market by ensuring as much consistency across the EU as possible. (Paragraph 147)

22. Good regulatory design requires that rules appropriately reflect the specific features of particular market segments. It also requires that where rules bearing on particular market activities, such as securitisation, are contained within a patchwork of rules, care is taken to ensure that such rules do not result in unintended effects. We call on the Commission to ensure that the crisis-era reform programme appropriately reflects the particular features of distinct markets and permits effective and safe securitisation. (Paragraph 154) (* Recommendation 11)

23. Smaller firms, some financial services providers (including certain asset managers) and non-financial firms have been disproportionately affected by EMIR, AIFMD and CRD IV/CRR. Inappropriate definitions and requirements have been put in place which have significantly increased the operational costs for Real Estate Funds, Private Equity Funds and Venture Capital Funds in particular. This demonstrates the dangers of a lack of proportionality in financial regulation, and the need to keep in mind the specific features of the financial sectors in question. We repeat our call for better quality Impact Assessments before further significant reforms are introduced. (Paragraph 164) (* Recommendation 12)

24. It is important to acknowledge the public outcry which the financial crisis generated and the popular and related political support for reform. It is also the case that, in principle, a stable and well-regulated financial market should lead to economic prosperity, creating growth and jobs. We are concerned that the compliance costs of such a vast set of regulatory reforms may have been underestimated, and that consequently their value for money was not properly assessed. It seems also that the knock-on consequences for the flow of credit to the real economy and for costs for end users, as well as the chilling effect on competition, were not taken sufficiently into account. (Paragraph 169)

25. The problems that have been encountered underline the vital need for effective Impact Assessments, both during the legislative process and post-implementation, taking full account of the predicted and actual costs of regulatory reform. (Paragraph 170) (* Recommendation 13)

26. We note the assessment of our witnesses that there were a few examples of excessive politicisation of the regulatory framework. Given the ramifications

of the crisis, it is understandable that some elements of the new EU financial sector regulatory framework were in part the result of political pressures to take prompt action, and/or to make the financial sector pay for the crisis. Such legislation runs the risk of being disproportionate in its application and economically damaging. Once again, this makes the case for rigorous Impact Assessments at each stage of the legislative process. (Paragraph 188) (* Recommendation 14)

### The international regulatory agenda

27. We welcome the efforts of EU leaders to assert the EU's influence in the international standard-setting agenda. We note in particular the continuing efforts to maintain a regulatory dialogue with the US. We reiterate our view that the EU is right to press the US to include financial services regulatory matters in TTIP. (Paragraph 214) (* Recommendation 15)

28. It is difficult to draw a distinction between G20 inspired measures and EU-specific reforms, and therefore to ascertain the extent to which the EU has been guilty of 'gold-plating'. This is particularly so given the influence of the EU and its Member States in the global standard-setting bodies and the breadth of the G20 agenda. On balance, however, we conclude that the EU has been at its most effective when implementing core elements of the G20 agenda and that regulatory design problems have been most apparent with respect to those measures whose connection to the G20 agenda is less apparent. Chief among these measures are AIFMD and the FTT proposal. (Paragraph 215)

29. The EU has also shown a tendency to interpret international standards according to the characteristics of the EU financial sector. We acknowledge that a completely level international playing field is unrealistic, at least in the immediate future, because of the different characteristics of global markets. Adjustments to take account of EU circumstances are understandable and sometimes justified. We also acknowledge that differences in implementation by EU Member States can make it more difficult to achieve a level international playing field. Yet it is in the long-term interests of the global financial system for key players, whether in the EU and the US, and increasingly in Asia and other developing markets, to work together to ensure that regulatory consistency is maintained. (Paragraph 216) (* Recommendation 16)

30. International fora such as the G20, the FSB and IOSCO have a crucial role to play in this process. They must be supported by the EU and its global partners, whether in terms of time, commitment and resources, if they are to prove effective. More specifically, greater co-ordination is needed at the international level to identify and lay out an effective process for ensuring international consistency in relation to the treatment of derivatives. (Paragraph 217) (* Recommendation 17)

### The implications for the UK

31. The Single Market has its imperfections and remains incomplete. Its benefits are also felt more keenly in the wholesale markets than in retail markets, where the benefits of cross-border services are less apparent. Nevertheless the Single Market remains a fundamental driver of growth across the EU and is thus of demonstrable benefit to the UK economy. Given the UK's leading

position, the development of the Single Market in financial services is a key determinant of the continued prosperity of the UK financial services sector. (Paragraph 221)

32. The steps towards further eurozone integration, encapsulated in Banking Union, are an essential precondition for the restoration of growth and prosperity both in the single currency area and across the EU as a whole. It is therefore in the UK's interests that a meaningful process of closer integration continues. (Paragraph 231)

33. Such integration has unavoidable consequences for the UK. There is little sign of eurozone caucusing taking place as yet, but it is certain that the eurozone will have to integrate even further if the future of the single currency is to be secured. Safeguards must be put in place to secure the integrity of the Single Market as well as the rights and interests of non-eurozone Member States. (Paragraph 232) (* Recommendation 18)

34. In that regard, we welcome the UK Government's successful campaign to reform the voting rules in the EBA. Yet such safeguards may not last forever, and voting weights in the Council have changed, giving the eurozone a qualified majority. Further protection is therefore needed. The new Commission must renew its commitment to the protection of the Single Market. The powers, authority and resources of the European Supervisory Authorities must be strengthened given their pivotal roles in supporting the single rulebook. We also recommend that the Eurogroup should meet after the ECOFIN Council rather than before, to reduce the risk of issues coming before the Council as a *fait accompli*. (Paragraph 233) (* Recommendation 19)

35. The UK authorities can also do more to take account of the growing influence of eurozone bodies such as the ECB and the Eurogroup. We welcome the fact that strong working relationships exist between the Bank of England and the ECB. Effective structures of co-ordination must be maintained in order to ensure that the UK's influence in the design of regulatory and supervisory structures is maintained. (Paragraph 234) (* Recommendation 20)

36. We acknowledge that elements of the financial sector regulatory framework have proved particularly problematic for the UK. The bank remuneration provisions in CRD IV, AIFMD and the longstanding arguments about the Financial Transaction Tax are three cases in point. There are also less prominent examples, not least in relation to the retail market. (Paragraph 241)

37. Yet with these exceptions, it is likely that the UK would have implemented the vast bulk of the financial sector regulatory framework had it acted unilaterally, not least because it was closely engaged in the development of the international standards from which much EU legislation derives. (Paragraph 242)

38. We acknowledge that UK regulation goes further than the EU baseline in a number of prominent cases. The arguments for and against gold-plating are finely balanced. On the one hand, the specific features of a financial market as developed as that in the UK need to be taken into account. On the other, the more regulatory inconsistency that is created, the greater the threat of regulatory arbitrage and of competitiveness risks. Such inconsistencies also

stand as impediments to the smooth functioning and development of the Single Market in financial services. On balance, we find that while it may sometimes be necessary to take account of the distinctive features of the UK markets, the assumption must remain that the advantages of consistency across the Single Market should prevail unless there is a clear and demonstrable case why this should not be so. (Paragraph 243)

39. It is fundamentally important that the Government must ensure that the UK is not perceived by EU colleagues to be pursuing an obstructionist or purely self-interested agenda. The Government needs to demonstrate by its actions and its words that it has the best interests of the Single Market and the EU as a whole at heart, and not just the UK's own narrow interests. (Paragraph 260) (* Recommendation 21)

40. It is gratifying to hear that the UK's expertise in relation to financial services is still respected. Yet it is our belief that the UK's influence over the legislative process continues to diminish. We identify several possible causes:

- The impact of the ongoing debate about the UK's place in the European Union on opinions about the UK;
- A perception of growing UK antipathy to "Brussels regulation";
- The indirect effect of hostility towards the financial services industry in light of that sector's prominence in the UK economy;
- An occasionally unhelpful tone and attitude on the part of UK authorities when dealing with EU counterparts;
- Insufficient commitment to the hard graft of effective lobbying, negotiation and alliance-building;
- A declining influence in the European Parliament, in spite of the hard work of those UK MEPs who remain constructively engaged;
- A paucity of senior UK officials in EU institutions. (Paragraph 261)

41. The UK Government must act urgently to increase the UK's influence over the future development of the financial sector regulatory framework. One practical step would be to place greater emphasis on the value of a career in the Brussels institutions for UK officials. A second would be to ensure that the UK seeks to influence the policy debate at the earliest opportunity. A third would be to enhance contact between UK authorities and MEPs not only from the UK but from all Member States. Given the importance of the financial sector to the UK economy, the Government would be failing in its duty to protect the interests of the UK if it did not do everything possible to enhance its influence among the EU institutions. (Paragraph 262) (* Recommendation 22)

42. In addition, all UK MEPs need to play a full and active part in the work of the Parliament and its Committees if the UK's influence within the European Parliament is to be enhanced. To that end, we also acknowledge this Committee's own responsibility to ensure that good relations between national parliaments and the European Parliament are maintained. (Paragraph 263) (* Recommendation 23)

43. We acknowledge that the EU must have confidence in its ability to regulate the City of London effectively if it is to retain its faith in and commitment to the City's continuing function as the global financial centre for the EU. The prosperity of the City of London, and the financial services industry that it hosts, is in the interests not only of the UK but of the EU as a whole. (Paragraph 267)

### The future

44. The pace and scale of legislative reforms over recent years were unprecedented. We sympathise with the pleas of the financial services industry for a period of calm and with its desire for a definitive end point to the process of reform. We agree that the legislative programme needs to slow down in order to enable industry to get to grips with the changes that have been made and to ensure effective implementation of the reforms that have already been agreed. (Paragraph 276) (* Recommendation 24)

45. Yet the vision of a fixed and completed regulatory framework is likely to prove a mirage. The financial sector is constantly evolving, and financial sector regulation will need to keep up. It is both unwise and unrealistic to set an artificial end point to the reform process. (Paragraph 277) (* Recommendation 25)

46. At the same time, the Commission should bring forward legislation only where the case for action has been effectively made. We have already criticised the Commission for a tendency to judge its effectiveness by its legislative output. We accordingly call on the new Commission to resist any urge to legislate without clear evidence of necessity. Increased regulatory stability is now highly desirable. (Paragraph 278) (* Recommendation 26)

47. We acknowledge that the shadow banking sector plays a pivotal role in the smooth operation of the economy, and in particular as a much-needed alternative financial driver to the regulated banking sector. Regulation intended to contain the risks of shadow banking must not prejudice its benefits to the wider economy and, in particular, its ability to support capital-market-based funding. Over-regulation will only drive risk into further unregulated areas. Reform must make shadow banking safer but not suppress it. (Paragraph 287) (* Recommendation 27)

48. The case for monitoring and regulation of the shadow banking sector is a strong one, in particular to take account of the shift in risk from the regulated sector into the unregulated sector, and the incentives which the enhanced regulation of banks has created for activities to move outside the regulated sector. Little is known about the intricacies of the shadow banking sector compared to the regulated banking sector. Enhanced transparency and understanding of the sector is therefore vital if systemic risks are to be identified and dealt with. (Paragraph 288) (* Recommendation 28)

49. The Commission's proposals for bank structural reform are highly contentious, particularly given that Member States including the UK, Germany and France have already brought forward structural measures at national level. This illustrates many of the failures in the legislative process that we have highlighted, including a counter-intuitive scheduling of legislative reforms. The optimal moment for bank structural reform had

passed by the time the proposal was brought forward in the dying days of the old European Parliament and Commission. (Paragraph 294)

50. Nevertheless, we are concerned that the financial sector is overstating its objections in an effort to encourage the Commission to drop the proposals. The lack of consistency between the Volcker, Vickers and Liikanen models, not to mention the national reforms taken forward by Germany and France, is far from ideal. The case for seeking to create greater harmonisation of bank structural rules across the EU is thus, in theory, a strong one. Nevertheless, the political reality is that it will now be very difficult to reach agreement on the proposal. Whether the Commission and the co-legislators have either the commitment or the resolve to reach such an agreement is open to doubt. (Paragraph 295)

51. The need for growth to be restored to the EU becomes more urgent by the day. Fears that the EU may slip yet again into recession have been exacerbated by the growing threat of a deflationary spiral. The Commission must do all it can to promote growth, in particular by promoting access to finance for SMEs. We welcome the fact that the co-legislators have reached agreement on the European Long-Term Investment Funds (ELTIFs) regulation. (Paragraph 306) (* Recommendation 29)

52. The new Commission's efforts to promote a growth agenda through the proposed Investment Plan for Europe are also to be welcomed. But primary responsibility for restoring growth and competitiveness remains with Member States, who must promote growth-friendly policies, and press on with structural reforms and the completion of the Single Market. Creditor Member States have their own obligations to stimulate growth and demand. (Paragraph 307) (* Recommendation 30)

53. We welcome the concept of Capital Markets Union, which has the potential to be an important and necessary initiative by the Commission, and a logical step towards completion of the Single Market. Opening up the EU's capital markets is a fundamental means of countering the overreliance on bank funding in the EU, and of enabling SMEs to access finance in a more effective way. Capital Markets Union provides an ideal opportunity for addressing securities law, reviewing the Prospectus Directive and considering the role of crowdfunding as a funding tool. Nevertheless, we caution against Capital Markets Union being used as a justification for a further wave of legislation. (Paragraph 315) (* Recommendation 31)

54. Capital Markets Union presents a golden opportunity for the UK to promote the importance of capital markets, as an alternative to bank funding, in the functioning of the EU economy. It is therefore imperative that the Government ensures that the UK is at the front and centre of the debate about Capital Markets Union in the months ahead. It also provides a means to demonstrate afresh that the City of London, and the financial sector which is centred there, is an asset not only to the UK economy but to the EU as a whole. (Paragraph 316) (* Recommendation 32)

### Overview

55. The post-2008 financial crisis was the most severe in living memory, and its effect is still being felt today. The ramifications for the EU have been particularly acute, and the 41 legislative proposals have brought about a

radical transformation in the EU financial sector regulatory framework. Given the scale of the task they faced in responding to a once-in-a-generation crisis, the EU institutions have performed well in achieving significant reform of the framework. Yet that regulatory framework inevitably contains some weaknesses. The role of the ESAs needs to be strengthened. Some regulatory reforms were the result of political pressures to take prompt action, and/or to make the financial sector pay for the crisis. The need to promote the growth agenda was only belatedly recognised. There was not enough recognition of the cumulative impact of the reforms on the financial sector. (Paragraph 317)

56. It was also inevitable, given the amount of new legislation, its broad range and the speed of its introduction, that there would be a number of inconsistencies, rough edges and elements which, with the benefit of hindsight, were disproportionate or even misguided. We welcome the commitment of the new European Commissioner for Financial Stability, Financial Services and Capital Markets Union, Lord Hill of Oareford, to "look not just at individual measures where reviews are already written in to European legislation, but at the cumulative effect of the different pieces of legislation." With that commitment in mind, we recommend that the Commission launches a thoroughgoing internal audit of the entire legislative framework to date, with a view to making recommendations both to remedy those key weaknesses in the current framework and to point up lessons learned in handling the crisis which might be applied in any future crisis of similar magnitude. (Paragraph 318) (* Recommendation 33)

57. The coming months and years provide an opportunity to take stock and to ensure effective implementation of the reforms that have already been introduced. Yet the financial sector will not stand still, and the regulatory framework will need to keep up. The economic challenges facing the EU are immense. In that vein we welcome the Commission's proposals for an Investment Plan for Europe and for a Capital Markets Union. Yet the responsibility for promoting growth and prosperity lies not only with the Commission and the EU institutions but with every Member State. There can be no excuse for a failure to act. (Paragraph 319)

# The post-crisis EU financial regulatory framework: do the pieces fit?

## CHAPTER 1: THE REGULATORY FRAMEWORK IN CONTEXT

### The outbreak of the crisis and the EU's regulatory response

> "In 2008, the world was hit by a financial crisis which was global in scale and imposed significant costs on the EU economy and its citizens. In the immediate aftermath of the crisis, the EU took the lead in a decisive global regulatory response. Together with its international G20 partners, the EU committed to engage in a fundamental overhaul of the regulatory and supervisory framework of the financial sector."

1. So stated the European Commission.[1] On 15 April 2014 (quickly dubbed 'Super Tuesday') the European Parliament adopted a final suite of legislative measures relating to the EU's substantial crisis-era reform programme. This reform agenda—a set of some 40 legislative proposals and accompanying radical institutional reforms—has led to a fundamental reconfiguration of EU financial law. Rules, supervision, and the institutional structure of supervision have all been affected in a way never before seen in democratic countries. EU law in this area has both significantly increased in breadth—harmonised rules now govern nearly all financial services activity in the EU—and in depth—the crisis-era agenda has seen a swathe of market participants, including non-financial participants, drawn into the regulatory net.

2. The EU reforms are multi-dimensional and many can be linked to the G20 crisis-era reform agenda. Some, such as European Market Infrastructure Regulation and the Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulation (CRR), are very closely associated with the G20 agenda and its concern to secure financial stability. Others, such as the Alternative Investment Fund Managers Directive (AIFMD), the Short Selling Regulation, and the proposed Financial Transaction Tax (FTT), primarily reflect EU-specific crisis-era concerns and political conditions. As we set out in Chapter 4, some of these reforms might be regarded as ill-advised or excessively politicised. Others are mainly concerned with reforms to longstanding EU measures but have been coloured by the financial crisis and the G20 agenda (such as the revised Markets in Financial Instruments Directive (MiFID II) and Regulation (MiFIR)). Still others are EU-specific institutional reforms, such as the Banking Union framework and the establishment of the European Supervisory Authorities (ESAs).

3. The major legislative reforms are set out in Appendix 4. The list demonstrates that the legislative programme has emerged over time, with the first reforms coming into force during 2009. All of the main reforms will have come into force in early 2017 although some measures have later implementation dates.

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1 Communication from the Commission: *A reformed financial sector for Europe*, COM(2014) 279 FINAL

## Categorising the nature and objectives of the legislative response

4. The regulatory framework seeks to achieve various objectives:

- Restoring and deepening the EU Single Market in financial services;
- Establishing a Banking Union;
- Building a more resilient and stable financial system;
- Enhancing transparency, responsibility and consumer protection to secure market integrity and restore consumer confidence; and
- Improving the efficiency of the EU financial system.[2]

5. The European Parliament Economic and Monetary Affairs Committee (ECON) has had responsibility for examining the legislation in close detail. Its former Chair, Sharon Bowles, usefully categorised the legislation as follows:[3]

- Legislative proposals that were already in train when the financial crisis erupted, and which were modified to take account of its effects;
- Regulation deriving from the G20 agenda;
- Efforts to update elements of the original 1999 EU Financial Services Action Plan which were due for review;
- Legislation seeking to remove barriers to the completion of the Single Market;
- Elements where the EU had sought to lead the way in the global response to the crisis, as well as outstanding proposals where work has yet to be completed;
- Banking Union; and
- The creation of the European Supervisory Authorities (ESAs).

6. We now set out the main driving forces behind the regulatory reform agenda.

## The international agenda

7. A defining feature of the reforms is that they were shaped by the EU's obligations to implement the G20-driven international standards on financial sector regulation. The EU crisis-era measures which are most strongly associated with the G20 agenda are as follows:

- The reforms to bank capital, liquidity, leverage, and prudential regulation (including with respect to remuneration) generally contained in the 2013 CRD IV/CRR package. These reflect the G20 concern to

2 *Ibid.*

3 Q 2

reduce procyclicality[4] and systemic risk, and implement the related Basel III agreement.

- The reforms relating to resolution, including the 2014 Bank Recovery and Resolution Directive (BRRD), which reflects the G20 'too-big-to-fail' agenda and related Financial Stability Board (FSB) standards.

- The shadow banking reforms. The G20 agenda on shadow banking, and related FSB standards, is reflected in a range of measures, including the CRD IV/CRR package and the 2013 Money Market Funds (MMFs) Proposal.

- The securities and derivatives market reforms. The 2012 European Market Infrastructure Regulation (EMIR) and the 2014 MiFID II/MiFIR package are together designed to foster extensive reforms to the structure of the over-the-counter (OTC) derivatives market. They are also designed to enhance derivatives market transparency, thereby implementing G20 obligations and the related extensive standards adopted by the international standard-setting bodies (SSBs), including IOSCO.[5] The reforms to trading market transparency contained in the MiFID II/MiFIR package also reflect the G20 agenda.

- The G20 agenda on credit rating agencies is reflected in the reforms contained in the Credit Rating Agency (CRA) Regulations I (2009), II (2011), and III (2013).

- The reforms to the financial reporting regime applied in the EU through implementation of the International Financial Reporting Standards (IFRS) reforms also reflect the G20 agenda.

8. These EU measures have, however, also typically built on the G20 agenda commitments to varying degrees, depending on the particular political/institutional context and the distinct features of the EU financial system.

9. We explore these issues in detail in Chapter 5.

## Deepening the Single Market and the creation of the single rulebook

10. The Commission asserted that "the financial crisis showed that no Member State alone can regulate the financial sector and supervise financial stability risks when financial markets are integrated."[6] While the 1999–2005 Financial Services Action Plan reforms had ensured that detailed harmonised rules governed much of the EU financial system, there remained: a number of non-regulated sectors; silo-based divergences in how rules applied to functionally-similar participants, services, and products; minimum standards which caused implementation difficulties; and dangers of divergence at national level with consequent regulatory and supervisory risks.

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[4] Procyclicality emerged as a major threat to financial stability over the financial crisis. In the context of the financial crisis reforms, it is associated with the systemic underestimation and overestimation of the risks to which the banking sector is exposed. This can lead to high levels of growth but poor risk assessment during an upward economic/financial sector cycle, to strong risk aversion during downward cycles, and to related financial system inability and weakness in the real economy.

[5] The International Organization of Securities Commissions.

[6] *A reformed financial sector for Europe*

11. This sometimes led to uncertainty among market participants operating cross-border (particularly cross-border groups); facilitated regulatory arbitrage; generated inefficiencies, including in the field of risk management; and undermined incentives for mutually-beneficial cooperation.

12. The financial crisis exposed major failures in the pre-crisis rulebook. Many market participants and asset classes operated outside the rulebook, reflecting the pre-crisis tolerance of self-regulation and faith in market discipline. This arose from pressure, often from the UK, for 'light-touch' regulation, and, as in the USA, excessive respect for the wisdom of the markets. The rulebook also failed to address the risks arising from system interconnectedness. Accordingly, it proved inadequate in monitoring and containing the dangerous build-up of risk in the EU financial system prior to the outbreak of the financial crisis. It also failed to respond to the institutional and supervisory issues raised by cross-border crisis management. When the crisis erupted the EU, and indeed others, were ill-equipped to respond.

13. The Commission therefore sought to ensure a consistent response to the crisis across the EU, which would also allow for better co-ordination with international partners. Reflecting the de Larosière Group Report,[7] which called for a consistent set of rules, the Commission proposed the establishment of a 'single rulebook', providing a single regulatory framework for the financial sector and its uniform application across the EU.[8]

14. Much of the EU legislative agenda can be associated with this concern, including:

- The expansion of the market abuse regime and its transformation from a directive into a regulation (2014 Market Abuse Regulation (MAR));
- The widening of the regulatory perimeter for trading venue regulation by MiFID II/MiFIR and the extension by MiFID II of the conduct regime applying to the distribution of investment products to cover deposit-based investment products;
- The detailed banking rulebook imposed by the CRD IV/CRR package;
- The detailed insurance rulebook (2009 Solvency II Directive and 2014 Omnibus II Directive);
- The introduction of a new regime governing fund management (other than 'UCITS' fund management[9]) by the 2011 AIFMD;
- The tightening of the 'UCITS' fund management regime, particularly by means of the much enhanced harmonisation of depositary rules (2014 UCITS V Directive);

7 The High Level Group on Financial Supervision in the EU, Report (25 February 2009): http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf [accessed 9 January 2015]

8 *A reformed financial sector for Europe*

9 The 'UCITS' (Undertakings for Collective Investment in Transferable Securities) regime is long established and very broadly, is directed to retail-market-oriented funds.

- The extension of the insurance mediation regime and the application of more intensively harmonised rules (the 2012 Insurance Mediation Directive II Proposal);
- The cross-sector harmonised regime which now applies to the disclosure required on investment products (the 2014 Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs Regulation);[10] and
- The enhancements to the pan-EU statutory audit regime (2014 Statutory Audit Regulation).

15. There is also an association between the single rulebook agenda and the significantly increased reliance on 'Level 2' detailed rules to expand crisis-era measures, as well as with the establishment of the new ESAs.

### The creation of the European Supervisory Authorities (ESAs)

16. The financial crisis triggered a debate about how best to redesign the institutional structure supporting the EU financial system of supervision. These issues were examined by the de Larosière Group, whose recommendations were accepted by the European Commission. In September 2010 EU legislation was passed which laid the foundation of a new EU supervisory institutional architecture.

17. The new European System of Financial Supervision (ESFS), which came into effect in January 2011, is based on a network model. Supervision remains, for the most part, at national level and with national competent/regulatory authorities (NCAs). The three new European Supervisory Authorities (ESAs) are, though, charged with distinct supervisory and quasi-regulatory responsibilities designed to enhance pan-EU supervision and rule-making. They operate on a sectoral basis and comprise: the European Banking Authority (EBA); the European Securities and Markets Authority (ESMA); and the European Insurance and Occupational Pensions Authority (EIOPA).[11] The European Systemic Risk Board (ESRB) also forms part of the ESFS and is charged with monitoring the pan-EU financial system for macroprudential/systemic risks. It co-ordinates closely with the ESAs and NCAs and can exercise a range of related 'soft' powers, notably with respect to giving warnings on macroprudential and systemic risks.

18. We explore the role of the ESAs in more detail in Chapter 3.

### Banking Union

19. The Commission stated that the crisis highlighted weaknesses in the institutional structure supporting the economic and monetary union. As the European banking market began to fragment, the integrity of the euro and

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10 The regime was originally termed the Packaged Retail Investment Products Regulation (the PRIPs Regulation) but was changed to the Packaged Retail and Insurance-Based Investment Products Regulation (the PRIIPs Regulation) during the final negotiations to reflect more accurately the scope of the new regime. In particular, it extends to insurance-based investment products and includes, for example, powers for EIOPA to prohibit the sale of certain insurance-based products.

11 See European Union Committee, *The European Financial Supervisory Framework: An Update* (20th Report, Session 2010–12, HL Paper 181)

the Single Market was called into question. Furthermore, the interconnections between Member States and their national banking systems had a negative impact on sovereign financing, weakening banks and the financial system even further. The Commission called for "deeper integration, at least in the euro area, for the supervision and resolution of banks".[12]

20. The result was the creation of a European Banking Union, described by the Commission as "probably our most ambitious common project since the creation of the euro".[13]

21. The Banking Union construct comprises two main elements:

- A Single Supervisory Mechanism (SSM) which transferred key supervisory tasks for major banks in the euro area and in other Member States choosing to participate in Banking Union to the European Central Bank (ECB), as of November 2014.[14] In preparation for taking on this role, the ECB conducted an Asset Quality Review (AQR) and, in conjunction with the EBA, stress tests of banks.

- A Single Resolution Mechanism (SRM) which introduced an integrated resolution process at European level for all banks in Member States subject to the SSM. Resolution will be financed in the first place by shareholders and creditors and, as a final recourse, by a Single Resolution Fund, funded through bank contributions.

22. The third leg of Banking Union as originally proposed, a Single Deposit Guarantee Mechanism, was quickly dropped under pressure from Germany. Banking Union can also be associated with the European Stability Mechanism which can be deployed to recapitalise Banking Union banks, subject to the relevant conditions being met.

23. This Committee has compiled two detailed reports on Banking Union. The first, *European Banking Union: key issues and challenges*, assessed the Single Supervisory Mechanism.[15] The second, *'Genuine Economic and Monetary Union' and the implications for the UK* focused on the Single Resolution Mechanism.[16]

## Assessing the regulatory framework agenda

24. While there has been widespread recognition of the necessity of the reforms, their scale and intensity has inevitably given rise to debate. For instance, the UK Government observed that:

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12 *A reformed financial sector for Europe*

13 European Commission, Internal Market and Financial Services, *Five years of laying the foundations of new growth in Europe*, (2014): http://ec.europa.eu/internal_market/publications/docs/legacy/legacy_en.pdf [accessed 9 January 2015]

14 The ECB exercises direct supervisory control over 120 significant banks and banking groups and is responsible for the SSM as a whole.

15 European Union Committee, *European Banking Union: Key issues and challenges* (7th Report, Session 2012–13, HL Paper 88)

16 European Union Committee, *'Genuine Economic and Monetary Union' and the implications for the UK* (8th Report, Session 2013–14, HL Paper 134)

> "A significant overarching feature of EU financial services regulation since the financial crisis has been its sheer quantity. Over the last ten years, there has been a roughly ten-fold increase in the volume of EU law on financial services as international standards have become more detailed and national rules have been replaced by EU-level rules, many of which are additional to rules that legislate and implement global commitments."[17]

25. Our witnesses cited a number of specific concerns, including:

- The quality, effectiveness, and flexibility of the EU legislative process, including the role played by the ESAs, and related inconsistencies and implementation risks in the new regulatory regime, particularly given the rigidity in the legislative process and an inability to correct errors quickly;
- The appropriate application of maximum harmonisation and, in particular, the optimal location (whether at EU or Member State level) of financial stability-oriented intervention;
- The need to look out for unintended consequences;
- The overall impact of the regime and in particular the cost for the financial sector (and by implication for consumers of financial products) of compliance with the regulatory agenda;
- The disproportionate impact of the reforms upon certain elements of the financial sector, including upon non-financial counterparties and upon elements of the asset management sector;
- The potentially prejudicial impact of the new regime on growth, despite the need for the EU to adopt growth as a priority objective, and the risk that the post-crisis Capital Markets Union agenda might increase the regulatory burden rather than embed the growth agenda;
- The need for a period of calm in the regulatory agenda to allow markets and institutions to focus on implementation and to ensure effective supervision follows, balanced by support for review of problematic elements of the major measures;
- The ability of the EU appropriately to address emerging risks and its treatment of ongoing reforms, including the shadow banking and 'too-big-to-fail' reforms;
- Potential conflict between the Single Market and its single rulebook and attempts to stabilise and strengthen the eurozone;
- The need to take account of the impact of the new regime on the international market and on third country access to the EU.

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[17] HM Government, *Review of the Balance of Competences between the United Kingdom and the European Union: The Single Market: Financial Services and the Free Movement of Capital* (Summer 2014): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332874/2902400_BoC_FreedomOfCapital_acc.pdf [accessed 9 January 2015]

### This report

26. The reform programme is not yet at an end. The Commission has stressed that agreement on key legislative proposals such as those relating to bank structural reform, shadow banking and financial benchmarks remain outstanding. In addition, the new Commission President, Jean-Claude Juncker, has asked the new UK Commissioner, Lord Hill of Oareford, to take forward proposals for a 'Capital Markets Union'.[18] Nevertheless, the Commission has publicly stated that the majority of reforms have now been agreed.[19]

27. Witnesses pointed out that it was too early for a final analysis of the regulatory framework.[20] Much of the legislation has yet to come into force and the extent to which the various legislative dossiers complement or conflict with one another will only become apparent as it does so. In addition, many of the dossiers will indeed be subject to automatic review over the next three to five years.

28. Nevertheless, the completion of the initial programme of legislative reforms, together with the election of a new European Parliament in May 2014 and the appointment of the new European Commission in November 2014, presents an opportunity to take stock of the reforms.

29. In reaching our conclusions we have been aided by oral and written evidence received from key participants, experts and stakeholders in the regulatory reform agenda. We also took evidence during a visit to Brussels in September 2014. Witnesses to our inquiry included:

- Michel Barnier, the then Commission Vice-President and Commissioner for the Internal Market and Services;
- Andrea Leadsom MP, Economic Secretary to the UK Treasury;
- Andrew Bailey, Deputy Governor for Prudential Regulation, Bank of England;
- Sir Jon Cunliffe, Deputy Governor for Financial Stability, Bank of England;
- David Lawton, Director of Markets, and Christopher Woolard, Director of Policy, Financial Conduct Authority (FCA);
- David Rule, Executive Director, Prudential Policy, Prudential Regulation Authority (PRA);
- Andrea Enria, Chairperson, European Banking Authority (EBA);
- Verena Ross, Executive Director, European Securities and Markets Authority (ESMA);

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18 See Chapter 7.

19 *A reformed financial sector for Europe*

20 See for instance Q 3 (Sharon Bowles), Q 80 (Wim Mijs) and QQ 187, 192 (Sally Dewar, Managing Director, JP Morgan).

- Sharon Bowles, former Chair of the European Parliament Economic and Monetary Affairs (ECON) Committee;
- Douglas Flint, Group Chairman of HSBC Holdings plc;
- Leading representatives of the financial sector, thinktanks, politicians and academic experts.

30. We are grateful to all our witnesses.[21] We are particularly grateful to Professor Niamh Moloney, Professor of Law, London School of Economics, who acted as Specialist Adviser for this inquiry.

31. We trust that the end result will be a helpful resource to policymakers and practitioners both in the UK and the EU, as they grapple with the effects of the massive legislative enterprise that is now nearing its completion. In that spirit, **we make this report to the House for debate.**

21 A full list of witnesses is set out in Appendix 2. The list of Committee members and declarations of interest is set out in Appendix 1. The inquiry Call for Evidence is set out in Appendix 3.

# CHAPTER 2: THE ROLE OF THE EU INSTITUTIONS

## Overview

32. This chapter examines the role of the EU institutions in the development of the financial sector regulatory framework. In particular, we examine:

- The Commission;
- The European Parliament;
- The Council of the European Union (also referred to as the Council of Ministers);
- The European Council.

## The Commission

33. The Commission played a key role in laying out the proposed new financial regulatory framework and in setting the general policy direction of the crisis-era reforms.

34. Many of our witnesses were positive about the Commission's role. David Lawton told us that it had been a mammoth undertaking to bring forward 41 pieces of legislation. This was particularly impressive given that no-one had a comprehensive blueprint in mind in 2008.[22] Karel Lannoo, Chief Executive Officer, Centre for European Policy Studies, thought that the outgoing Commissioner for the Internal Market and Services, Michel Barnier, had done a good job in piloting the majority of these legislative reforms.[23]

35. Professor Lucia Quaglia, Professor of Political Science, University of York, thought that the Commission had sought to balance what was economically feasible with what was politically feasible.[24] Sir Jon Cunliffe said that the Commission had by and large done a good job in implementing the G20 agenda, although there were inevitably compromises.[25] The Minister, Andrea Leadsom MP, noted the scale of the challenge that the Commission had faced in responding to the worst financial crisis in history. She said that the UK Government's view was that the majority of the reforms were the right things to have done.[26]

36. Sharon Bowles said that the Commission took consultation and the input from the financial sector seriously.[27] Mike Vercnocke, Head of Office, City of London Office in Brussels, noted that the City of London's relationship with the Commission was improving as the latter realised it had initially gone too far in terms of impinging upon the effectiveness of the market.[28]

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22 QQ 229, 231

23 Q 66

24 Q 28

25 Q 255

26 QQ 271–72

27 Q 9

28 Q 130

37. Understandably given the scale of the challenge, some problems had arisen. Nicolas Véron, Senior Fellow at Bruegel and Visiting Fellow at the Peterson Institute for International Economics, thought that Michel Barnier's "famous colour-coded table of pieces of legislation gave the impression that the Commission was about quantity not quality, which was not necessarily the right signal to give".[29] Mike Vercnocke and the International Regulatory Strategy Group (IRSG) suggested that the sequencing of the legislation was counter-intuitive, for instance in pursuing AIFMD ahead of shoring up the banking sector.[30]

38. Christos VI Gortsos, Professor of International Economic Law, Panteion University of Athens, stated that the political pressure to act swiftly meant that some legislation lacked a robust cost-benefit analysis of its impact.[31] Citing EMIR as an example, Colin Tyler, Chief Executive, Association of Corporate Treasurers, agreed that there was "no walk-through test for new legislation" as to whether it would work in practice.[32]

39. Anthony Browne, Chief Executive, British Bankers' Association (BBA) was critical of the Commission's Impact Assessments, some of which, he pointed out, had not survived close scrutiny even by the other EU institutions.[33] The Minister agreed.[34] One particular concern was the lack of a mechanism for measuring the impact of substantive amendments made during the legislative process. The IRSG said that this was a problem given the extent to which some legislative texts were radically transformed during the negotiation process.[35]

40. Some witnesses drew attention to the resource pressures that the crisis had given rise to. Professor Simon Gleeson, Partner, Clifford Chance, thought it "suboptimal" that in spite of the fact that DG MARKT had quintupled its workload, its staffing did not increase at all.[36]

41. Simon Gleeson added that one of the most serious policymaking errors in Brussels was a failure to look in the round at the overall impact of the legislative programme.[37] Douglas Flint told us:

> "The financial system is a bit like a big jigsaw box and the regulatory reforms are effectively pieces thrown into the jigsaw box, but no one is given the lid with the picture on it … Everything that has been done so far has been done with good intent, but when you add it all together, is it coherent within itself?"[38]

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29 Q 49

30 Q 126 (Mike Vercnocke), written evidence from the International Regulatory Strategy Group (FRF0017)

31 Written evidence from Christos VI Gortsos (FRF0011)

32 QQ 219, 228

33 Q 194. See also written evidence from the British Private Equity and Venture Capital Association (FRF0010); and Q 69 (Karel Lannoo).

34 QQ 273–76

35 Written evidence from the International Regulatory Strategy Group (FRF0017)

36 Q 49. See also written evidence from the British Property Federation (FRF0008).

37 Q 48

38 Q 200

42. **We acknowledge the daunting and unenviable task that the Commission faced in responding to a once-in-a-generation crisis. In that context, the sheer output and workrate of the Commission is to be admired. Unsurprisingly, the scale of the crisis placed the Commission under intense strain, not least in terms of stretched resources. As a result, the expected high standards of consultation and impact assessments were not always maintained. The Commission should also have focused more on the overall impact rather than the quantity of its legislative output. Yet this should not detract from the credit due to the Commission for its diligence in designing a legislative response to the worst financial crisis in living memory.**

43. **We welcome the new Commission's efforts to promote Better Regulation, led by First Vice-President Frans Timmermans. A key component of Better Regulation should be to ensure that a full assessment is undertaken of the impact of substantive amendments to legislation made during the negotiating process. While the Council and Parliament are primarily responsible for post-proposal changes, we urge the Commission to take the lead in ensuring effective impact assessment of major revisions is carried out. A mechanism for the swift reallocation of resources within the Commission to where it is most needed at a time of crisis also needs to be put in place.**

### The European Parliament

44. The Lisbon Treaty, which came into force in 2009, gave the European Parliament legislative powers over 40 new fields, thus enhancing its powers of co-decision, alongside the Council of Ministers, over a majority of legislative proposals. This has had a marked impact on the balance of powers and responsibilities amongst the EU institutions.

45. A number of serving or former MEPs stressed the importance of the European Parliament's work. Dr Kay Swinburne MEP asserted that it was the most important institution in terms of influencing legislation and providing democratic accountability. Although MEPs were not always experts on the fine detail of the regulations that came before them, Parliament was getting better at taking account of evidence and data before it legislated.[39] Former MEP and ECON Committee Chair Sharon Bowles praised the work of the European Parliament in improving legislation such as CRD IV.[40] She also observed that it had grown in stature during the crisis.[41]

46. Other witnesses came to similar conclusions. Anthony Browne thought that the European Parliament did an extraordinary job improving and passing the legislation, in particular given that it was not resourced to do so.[42] Karel Lannoo agreed, noting that the Parliament was often underestimated but had done a huge job.[43] Benoit Lallemand, Acting Secretary-General, Finance

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39 Q 146

40 Q 4

41 Q 9

42 Q 189

43 Q 66

Watch, noted the "pretty scary" number of amendments that the European Parliament proposed.[44] Sharon Bowles said that 30–40% of a legislative text was altered during the legislative process.[45]

47. Others painted a more nuanced picture. Professor Kern Alexander, Chair for Law and Finance, University of Zurich, thought that the ECON Committee has blossomed during the crisis and that no-one in 2008 had expected it to play such an important role. On the other hand, amendments such as the bank remuneration provisions in CRD IV were the sort of "prescriptive, legislative regulation at the EU level [that] has not really produced beneficial results in the EU."[46] Simon Gleeson thought that the European Parliament had been a surprisingly effective vehicle for making small improvements to legislation. By contrast, when it sought to undertake grand projects like the bank remuneration provisions in CRD IV, "they tend to be embarrassing or wrong".[47] Although Standard Life described the work of the European Parliament as invaluable, it stressed that surprise last-minute amendments could also incur significant planning costs for firms.[48] We explore some such cases in Chapter 4.

48. One specific concern related to the European Parliament's ability to scrutinise Level 2 measures. Karel Lannoo warned that there was insufficient democratic accountability: "Parliament has three months to react, and if it does not react, it is adopted. That means that the Commission has almost a free hand."[49] Kay Swinburne MEP conceded that the European Parliament faced resource constraints with regard to oversight of Level 2. This was a particular issue given her statement that 420 pieces of Level 2 legislation were coming down the track.[50] We explore this issue in more detail in Chapter 3.

49. The European Union Committee's 2014 report on *The Role of National Parliaments in the European Union* reflected on the importance of inter-parliamentary co-operation. It concluded that "national parliaments and the European Parliament have a vital, and complementary, role to play in the European Union … There is scope for national parliaments and the European Parliament to engage more effectively with each other, sharing information and debating key policies."[51]

50. **The European Parliament has played an equally diligent role in its scrutiny of all aspects of the EU financial sector regulatory framework. We particularly acknowledge the way in which its Economic and Monetary Affairs Committee (ECON) Committee has developed expertise in this policy area. Nevertheless the Parliament has been prone to occasional popular (and populist) reforms that have not stood up to scrutiny. It has also faced resource constraints in**

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44 Q 84

45 Q 9

46 Q 30

47 QQ 48–49

48 Written evidence from Standard Life (FRF0024)

49 Q 65

50 Q 154

51 European Union Committee, *The Role of National Parliaments in the European Union* (9th Report, Session 2013–14, HL Paper 151)

**responding to a legislative framework of such magnitude. The sheer volume and scope of pending Level 2 measures means that such constraints are unlikely to ease in the near future. We also reiterate that national parliaments and the European Parliament have a vital, and complementary, role to play in the European Union, and that there is scope for them to engage more effectively with each other.**

### The Council of the European Union

51. The second of the co-legislators is the Council of the European Union, also known as the Council of Ministers, representing the governments of the 28 Member States.[52]

52. Kern Alexander stressed that the representation of Member States in the legislative process was vital in terms of democratic accountability. Yet the tendency of Member States to vote according to the national interest led to fragmentation and a lack of co-ordination. He thought that the Council could have been more diligent in seeking to influence legislation and in looking at how the legislative programme as a whole fitted together.[53]

53. Sharon Bowles argued that it was to be expected that the Council would concentrate on ensuring legislation reflected national circumstances, with compromise the inevitable result.[54] Yet Lucia Quaglia said that this made the Council a more conservative institution than the Commission or the Parliament, with the end result that legislation was watered down.[55] The BBA gave the example of the "convoluted" process which emerged from Council negotiations for resolving a failed institution under the Single Resolution Mechanism.[56]

54. **The Council of the European Union performs a vital function in ensuring that the views of Member State governments are taken into account. This is particularly important in the case of the financial sector regulatory framework, given the scale of the crisis, the volume of the legislation proposed, and the diverse nature of financial systems across the 28 Member States. It was understandable that the Council became a forum for compromise in negotiations on legislative proposals. Yet the Council and its members must retain their focus on the broad effects of regulatory reform on the EU as well as on narrow national self-interest.**

### The European Council

55. One of the most noteworthy features of the crisis is the evolving role of the European Council, the gathering of the Heads of State or Government of the 28 Member States. A crucial step in this evolution was the appointment of the first full-time President of the European Council, the former Belgian Prime Minister Herman Van Rompuy, in 2009.

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52 Referred to as "The Council" throughout the remainder of this report.

53 QQ 30, 32

54 Q 9

55 QQ 29, 31

56 Written evidence from the British Bankers' Association (FRF0015)

56. Several of our witnesses stressed the growing influence of the European Council on financial regulation policy. Kern Alexander said that it had been a brake on the enthusiasm of the Commission in many cases, and provided a useful balance between the EU institutions and the Member States.[57] Yet Simon Gleeson observed "good old-fashioned institutional power politics" at play, arguing that the Commission "does not regard itself as subordinate to anyone".[58]

57. Nicolas Véron told us that one explanation for the European Council's enhanced influence was that EU institutions were in flux and lacked the institutional stability taken for granted in many countries. While on paper it was the Commission's job to bring a sense of consistency, President Van Rompuy had done a more effective job. Mr Véron was less sure if a prominent role for the President of the European Council would be a permanent feature of the institutional framework.[59]

58. Richard Corbett MEP worked in the Cabinet of Herman Van Rompuy between 2009 and 2014. He argued that the European Council's agenda-setting role derived from the nature of the crisis where Member States took the lead. In addition, the EU lacked instruments for dealing with a crisis of such magnitude.[60] Overall, Mr Corbett said that the advantage of dealing with an issue at the European Council was that the decisions of Heads of State or Government carried more weight. The disadvantage was that securing unanimity on policy questions could be a challenge amongst a group of national leaders. The appointment of a full-time President was crucial in terms of providing the European Council with greater cohesion. It was also fortunate in the circumstances that President Van Rompuy, a former Belgian Budget Minister and Prime Minister, was an economic expert and an experienced consensus-builder.[61]

59. **The European Council has played a pivotal role in co-ordinating the response of Member States to the crisis. It has also fulfilled an important agenda-setting function. It remains to be seen if this was a reflection of the personal skills and economic expertise of the former President, Herman Van Rompuy, or whether a prominent role for the President of the European Council will become a permanent feature of the institutional landscape.**

57 Q 30

58 Q 50

59 *Ibid.*

60 Q 161

61 Q 162

# CHAPTER 3: THE ROLE OF THE EUROPEAN SUPERVISORY AUTHORITIES (ESAS)

## Background

60. The other key institutions in respect to the EU financial sector regulatory framework were the three new European Supervisory Authorities (ESAs). This Committee scrutinised the ESAs' role in its 2009 report on *The future of financial regulation and supervision*,[62] and in its 2011 update report on *The EU Financial Supervisory Framework*.[63] Box 1 sets out their functions.

**Box 1: The European Supervisory Authorities (ESAs)**

The three ESAs are charged with a range of supervisory co-ordination and convergence tasks as well as with quasi-rule-making responsibilities. The latter are directed in the main to the support of the single rulebook and include providing technical advice to the Commission on Level 2 rules and, in the case of Level 2 rules in the form of Binding Technical Standards, providing the Commission with proposals for such rules. The ESAs' quasi-rule-making responsibilities also include the adoption of guidance in relation to which National Competent Authorities (NCAs) are required to 'comply or explain'. The ESAs are in addition conferred with a range of supervisory powers directed to the support of pan-EU supervisory convergence and co-ordination. These include peer review powers as well as more interventionist powers to engage in binding mediation and to direct NCAs to take particular action to comply with EU law in emergency conditions. With respect to the law-making process in particular, the establishment of the ESAs marked a significant change to the pre-crisis institutional environment, particularly with respect to delegated (Level 2) rule-making.

The ESAs were established in January 2011 under the 2010 ESA Regulations as independent EU agencies. The decision-making bodies of the ESAs are their respective Boards of Supervisors, chaired in each case by the permanent ESA Chairperson. The voting members of an ESA Board of Supervisors are the heads (or alternates) of the relevant NCAs. The permanent ESA Chairperson and Executive Director do not have voting rights. National expertise and concerns can, accordingly, be reflected in Board decision-making, although the ESAs and their Boards of Supervisors are charged with acting independently and objectively in the interest of the EU as a whole. The ESAs are accountable to the European Parliament and the Council. A number of mechanisms are deployed under the ESA Regulations to support ESA accountability, including the requirement on the ESAs to produce an annual report which must be transmitted to a number of EU institutions including the Council and European Parliament (and made public) and the requirement that an ESA Chairperson report in writing to the European Parliament on the activities of the ESA on request.

[62] European Union Committee, *The future of EU financial regulation and supervision* (14th Report, Session 2008–09, HL Paper 106)

[63] European Union Committee, *The European Financial Supervisory Framework: An Update* (20th Report, Session 2010–12, HL Paper 181)

61. The ESAs play a key role in relation to 'Level 2' rules. Box 2 sets out the Level 1 (equivalent to primary legislation) and Level 2 (equivalent to secondary legislation) processes in detail.

**Box 2: The Level 1 and Level 2 processes**

The EU legislative process for financial regulation is framed by the 'Lamfalussy' approach to financial regulation. Adopted by the EU in 2001, it characterises legislation in the financial sphere as following a 'hierarchy of norms' approach which distinguishes between high-level primary measures and technical secondary measures. Accordingly, and with respect to binding financial regulation, the EU legislative process produces 'Level 1' and 'Level 2' measures. Level 1 measures (equivalent to UK primary legislation) are, in theory, designed to take the form of framework principles and to reflect high-level political decisions on core elements of financial regulation. These measures take the form of directives or regulations and are adopted by the co-legislators.

Level 2 measures (equivalent to UK secondary legislation) are designed to take the form of technical, delegated rules and typically take the form of regulations. They are adopted by the Commission (the European Parliament and Council can only exercise veto powers) and are based on the specific mandates for delegated rule-making contained in the relevant Level 1 measures adopted by the co-legislators. Level 2 measures fall into two broad types: 'delegated' Level 2 measures which have a quasi-legislative nature and which are designed to supplement or amend non-essential elements of Level 1 measures; and 'implementing' Level 2 measures, which are of a more technical nature and which are designed to support uniform implementation conditions. A particular form of Level 2 measure, Binding Technical Standards, follow a distinct procedural route in that they are proposed by the ESAs and adopted by the Commission. With respect to other Level 2 measures, the ESAs provide technical advice to the Commission.

In principle, the revision of Level 1 measures through Level 1 amendments engages the Treaty co-decision procedure and its related complexities and inefficiencies. Revisions to Level 2 measures through the Level 2 process should be somewhat quicker, while Level 2 may also provide a means of amending non-essential elements of Level 1 measures.

62. In August 2014, the Commission published reports on the mission and organisation of the ESRB and on the operation of the ESAs and the ESFS. The Commission concluded that "in spite of difficult circumstances the ESAs have quickly established well-functioning organisations. Overall they have performed well against their broad range of tasks, while facing increasing demands with limited human resources."[64] The Commission recommended a number of short-term and medium-term improvements, including:

- An increased focus on supervisory convergence;
- Enhanced transparency in the preparation of draft technical standards;

[64] Report from the Commission on the operation of the European Supervisory Authorities (ESAs) and the European System of Banking Supervision (ESFS), COM(2014) 509 FINAL; Report from the Commission on the mission and organisation of the European Systemic Risk Board (ESRB), COM(2014) 508 FINAL.

- A greater focus on consumer and investor protection;
- Enhanced internal governance;
- More appropriate deadlines for implementation of technical standards;
- The use of alternative sources of funding instead of EU and national contributions;
- Direct access to data where necessary;
- Possible extension of the ESAs' mandates;
- Possible strengthening of dispute settlement powers;
- Possible structural changes including a single location for the ESAs and extended direct supervision powers.

63. Within this context we heard evidence from two of the ESAs—the EBA and ESMA. We also asked our other witnesses for their perspectives on the ESAs' role. The evidence we received focused on the following themes:

- The powers and status of the ESAs;
- The ESAs' role in the Level 2 consultation and implementation process;
- The flexibility of the legislative process;
- The ESAs' approach to consumer protection;
- The resources available to the ESAs;
- The EBA's relationship with the ECB.

### Powers and status of the ESAs

64. Michel Barnier told us that while the ESAs were doing well they were still young institutions. They had to be more than just a club of national supervisors, and needed to have their own authority.[65] Sharon Bowles agreed that the ESAs were in general performing well.[66] Interestingly, she thought that elements in the Commission regretted handing over power to the ESAs and were trying to claw things back.[67]

65. Wim Mijs, Chief Executive, European Banking Federation, questioned whether the ESAs could be truly called 'authorities' given their limited power.[68] Anthony Browne said that while the ESAs had done a good job, they were too weak, there was a lack of clarity about their role and they had insufficient independence from the Commission.[69] The Investment Management Association foresaw the ESAs becoming a political football

65 Q 108
66 Q 10
67 Q 12
68 Q 90
69 Q 196

between the Commission and the Parliament. This was regrettable because the ESAs' work involved genuine consultation with industry.[70]

66. Others were concerned about the implications of granting the ESAs more powers. The British Private Equity and Venture Capital Association (BVCA) argued that the ESAs should not have the power to legislate "through the back door", for instance in relation to AIFMD remuneration guidelines.[71] Nicolas Véron thought it would be problematic if an agency lacking in democratic accountability had the power to correct material mistakes in legislation.[72]

67. The Minister, Andrea Leadsom MP, argued that the ESAs should not encroach on the role of national competent authorities.[73] Their role should be to ensure that Member States were properly supervising their own financial sectors as distinct from doing it themselves.[74] She stated that the Government's vision was that the ESAs should be "strategic organisations that manage the overall system of supervision, ensuring there is a uniformly high standard of outcomes across the EU". The Government supported the majority of short-term improvements proposed by the Commission, including better use of peer reviews, greater transparency in drafting technical standards and improvements to internal governance. Yet the ESAs would not become more efficient by being given new tasks, since this could detract from their core focus. The Government felt that it would be particularly undesirable for the ESAs to take on more direct supervisory responsibilities, since this was best left to national regulators given their expertise and proximity to local markets.[75] The Wealth Management Association agreed that national competent authorities were better placed than ESAs to engage with small retail firms locally.[76]

68. We sought the views of the ESAs themselves on their powers and authority. The Chairperson of the EBA, Andrea Enria, said that it was not as engaged in the EU legislative process as he would like. This meant that the EBA's expertise was not utilised when primary Level 1 legislation was produced. While national authorities provided input in the context of Council working groups, the EBA was not allowed in the room or to see the documents being produced in those discussions: "Sometimes banks know about the developments in the legislative debates before we do." In addition, Mr Enria said that it was unsatisfactory that the EBA had no structured involvement in Commission Impact Assessments, in spite of the wealth of data at its disposal.[77]

69. ESMA's Executive Director, Verena Ross, said that it was absolutely right that ESMA was not directly or formally involved in the legislative process. However there would be benefits from being more involved in the Level 1

70 Written evidence from the Investment Management Association (FRF0025)

71 Written evidence from the British Private Equity and Venture Capital Association (FRF0010)

72 Q 54

73 Q 279

74 Q 284

75 Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, to Lord Boswell of Aynho, Chairman of the House of Lords European Union Committee, 27 November 2014

76 Written evidence from the Wealth Management Association (FRF0014)

77 Q 176

process; in particular, such involvement would give the ESAs a full understanding of what the co-legislators had in mind when they drafted a particular piece of legislation.[78]

70. Other witnesses agreed. The BBA argued that the ESAs should be able to provide technical support during the legislative process so that they were not just presented with a *fait accompli* to make sense of at the end of the process.[79] The Association for Financial Markets in Europe (AFME) argued that the ESAs should be allowed to participate as observers in technical discussions during the Level 1 legislative process. AFME also called for the ESAs to conduct cumulative, net impact assessments as a matter of course.[80] Sir Jon Cunliffe agreed that the technical expertise of the national competent authorities in the ESAs needed to feed more directly into the process.[81]

71. The Minister wrote to the Committee to state that the Government believes that there could be benefits in greater involvement of the ESAs in the legislative process, "on the basis that their expertise and understanding of the impact of rules on firms should help to improve the quality and coherence of the rules that emerge from the process." Suggestions included: ensuring the Commission consulted with the ESAs at the start of the Level 1 process on their ability to deliver; a requirement for the ESAs to publish an assessment of all new proposals, covering the quality of evidence and analysis in Commission Impact Assessments, the implementation timetable, and any issues with Level 2 delegating provisions; and requiring the ESAs to publish *ex post* assessments of the extent to which legislation met its regulatory objectives. However, care needed to be taken to ensure that the role of the ESAs was appropriate and commensurate with their existing functions.[82]

### The ESAs and the Level 2 process

72. A significant concern was the limited time made available to the ESAs with respect to their Level 2 work in support of the single rulebook. Concerns were raised in particular in relation to the time available to the ESAs to develop their technical advice for the Commission, to develop their proposals to the Commission for Binding Technical Standards, to engage in related consultation with stakeholders and to engage in impact assessment.

73. Anthony Browne told us:

> "Legislation tends to be set out with an absolute date when something has to be done by, and delays earlier in the process mean that ESAs are given a very short time to do a lot of very detailed technical work, in consultation with the industry, over incredibly short timetables. As a result of that, you do not necessarily get good results."[83]

74. Several witnesses gave examples. Colin Tyler cited the process for EMIR as "a bit of a shambles". ESMA had little time to prepare the related Level 2 measures and had not thought through all the issues. Providing guidance on

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78 Q 242

79 Q 196

80 Written evidence from the Association for Financial Markets in Europe (FRF0012)

81 Q 255

82 Letter from Andrea Leadsom MP, 27 November 2014

83 Q 196

reporting on derivatives on the evening of the day the related legislation came in to force was "a tad late".[84] The BVCA complained about the unreasonably short ESMA consultation timelines set by the Commission in the case of AIFMD.[85] Aberdeen Asset Management cited ESMA's MiFID II/MiFIR Consultation and Discussion Papers, where little over two months were given to respond to an 844 page document.[86] David Lawton referred to the Short Selling Regulation, where a hard date was set in the Level 1 legislation for when the related Level 2 rules would take effect, but when the Level 1 negotiations slipped that date was not changed. As a result, ESMA was only able to hold a five week consultation on some of most important technical detail.[87]

75. Verena Ross agreed that the Short Selling Regulation was the most notorious example of a squeezed consultation process. Such cases had implications for interaction with stakeholders "because often we cannot fulfil what we generally try to do in terms of holding at least two rounds of consultation, having open hearings, and giving sufficient time for responses." It also increased the risk of getting things wrong. She said that the Parliament and the Council were now more aware of the issues, and they tried to provide more time. She argued that ESMA needed at least 12 months for the Level 2 process to work properly. Verena Ross also stated that ESMA was arguing for more flexible implementation deadlines which moved with the progress of negotiations rather than being fixed dates.[88]

76. AFME argued that the ESAs' opinion should be sought on the timeline to deliver Level 2 technical standards.[89] The BBA advocated setting deadlines for Level 2 standards not in absolute dates but as a drafting period which began from the date at which the Level 1 text was published in the Official Journal.[90] On the other hand, the Minister argued that the ESAs were seeking to do too much in too short a period of time. She also said that they needed to conduct better quality consultations with less focus on micro-level detail, which could be left to national competent authorities.[91]

77. A related concern was the ESAs' interaction with market participants. AFME stated that such dialogue could be improved by organising it into two distinct layers: the high-level representation of wide interests within the ESAs' Stakeholder Groups and a technical dialogue that would benefit from expertise in specific areas. As such, AFME argued that it might be necessary to review the selection criteria and process for appointment to the Stakeholder Groups and to have a more systematic involvement of technical consultative groups. It was also important to acknowledge that interaction between Stakeholder Groups and ESAs was no substitute for public consultation or technical dialogue with market participants.[92]

84 Q 225

85 Written evidence from the British Private Equity and Venture Capital Association (FRF0010)

86 Written evidence from Aberdeen Asset Management (FRF0022)

87 Q 232

88 Q 247

89 Written evidence from the Association for Financial Markets in Europe (FRF0012)

90 Written evidence from the British Bankers' Association (FRF0015)

91 Q 285

92 Written evidence from the Association for Financial Markets in Europe (FRF0012)

## The flexibility of the legislative process

78. Another specific concern was the inflexibility of the legislative process. Witnesses such as the BBA stressed the importance of review clauses (see Box 3) both in allowing for a timely assessment of the impact of a measure and to allow fine-tuning as necessary.[93]

**Box 3: Review clauses**

Review clauses in EU legislation require that the legislation in question is reviewed within a set time-frame. They first became widely used in relation to the Financial Services Action Plan reform agenda and are now a feature of EU financial regulation. All the major crisis-era Level 1 measures contain review clauses, which require that specified aspects of the measure in question be reviewed, usually in a two to three year time-frame. Typically, the Commission is charged with reviewing the operation and impact of particular aspects of a measure and with reporting to the Council and European Parliament. Review clauses usually address contested aspects of a measure, aspects where the likely impact might be unclear or where the evidence basis is uncertain, and areas which are likely to become important as the measure is applied. The 2010 ESA Regulation review clauses, for example, underpinned the Commission's 2013–2014 ESA Review, while the review clause contained in the 2012 Short Selling Regulation led to the Commission's 2013 review, which included empirical input on the short selling regime from ESMA. Proposals for legislative change may or may not follow a review. In the case of the Short Selling Regulation review, for example, the Commission concluded that it was too early to propose adjustments to the Regulation.

79. On the other hand, the Investment Management Association argued that review clauses went only a short way to addressing the problem of how to amend legislation quickly or create legitimate exceptions.[94] Simon Gleeson asserted that the single biggest weakness was that "we still do not have a mechanism for correcting errors in the European legislative process that does not take five years."[95]

80. Simon Gleeson was particularly concerned about the difficulties faced by the ESAs in correcting errors and improving legislation through the Level 2 process. He criticised the ESAs for taking the view that they were absolutely bound by the wording of legislation and were able to do nothing on their own initiative to correct errors. He cited an example of ESMA's inability to correct a drafting error in relation to uncleared derivatives: "It is an approach like that which basically makes these bodies really useless for amending and developing law and policy."[96]

81. Benoit Lallemand said that the ESAs lacked flexibility because they lacked autonomy: "If an error comes up you might have to go back to Level 1 and,

93 Written Evidence from the British Bankers' Association (FRF0015)

94 Written Evidence from the Investment Management Association (FRF0025)

95 Q 49

96 Q 54

as you know, that is three years minimum, which would be crazy. This is a big problem and it is embedded in the institutions as we have them."[97]

82. Andrea Enria said that the current situation was "impossible". He thought that the ideal situation would be for the ESAs to be trusted by EU legislators, thereby allowing for less detail in the primary Level 1 legislation and more delegation to the ESAs as technical authorities. Nevertheless "as long as the balance remains tilted towards the primary legislation—and in my view it will remain so for a while—the important thing is to engage the technical authorities more in the production of primary legislation."[98]

83. Verena Ross said that tools such as guidance and Q&As helped give the ESAs some flexibility. However there would be times where significant changes in market liquidity or structure required a quick reaction to ensure that the market continued to operate effectively. Amending a measure, however, could take six or nine months, "which is quite a long period of time in markets." She suggested that the EU could learn from the flexible model in the US, where requirements were phased in to see how things worked before they were implemented in the round.[99]

### Consumer protection

84. The ESAs are also charged with undertaking specific tasks relating to consumer protection, including taking a leading role in promoting transparency, simplicity and fairness in the market for consumer products and services. Although Sue Lewis, the Chair of the Financial Services Consumer Panel, welcomed the ESAs' consumer protection objective, she argued that it was not clear how they were discharging it. She argued that the ESA stakeholder groups were heavily dominated by industry and it was hard for consumer groups to acquire the necessary resources and expertise to participate.[100] The fact that many national authorities did not have a consumer protection objective inevitably made the ESAs' job harder.[101] The Financial Services Consumer Panel noted that the EBA's consumer protection unit, for example, had previously consisted of only two or three staff members.[102]

85. The Financial Services Consumer Panel also stated that the sheer volume and scope of financial services legislation made it difficult for consumer groups to respond effectively to Level 2 consultations. It gave the example of an ESMA consultation on MiFID II, which ran to 311 pages and contained 245 questions.[103]

86. Andrea Enria conceded that in the first years of its existence the EBA's focus had been on tackling the crisis and the implementation of standards. Consumer protection work was now increasing, for instance on product oversight and governance mechanisms within credit institutions.[104] Verena

97 Q 90

98 Q 184

99 Q 244

100 Q 220

101 Q 225

102 Written evidence from the Financial Services Consumer Panel (FRF0007)

103 *Ibid.*

104 Q 180

Ross also acknowledged that creating stability in the financial system had been the priority. Nevertheless, consumer and investor protection was core to ESMA's role.[105]

### Resources

87. Several of our witnesses cited the significant resource challenges faced by the ESAs in fulfilling these functions. Andrea Enria said that the EBA was very short of resources, with only 110 permanent staff: "For reasons that are difficult to understand, the Council and Commission in particular are keeping us even tighter going forward, notwithstanding the increasing number of tasks coming to us."[106] Verena Ross said that ESMA currently employed 165 people. She agreed that the Commission's budgetary proposal would make "the continuing growth of the task and our responsibilities very difficult to manage."[107]

88. Colin Tyler compared the small number of ESMA staff to over 4,000 at the FCA.[108] Anthony Browne said that the EBA had a remarkably small number of staff relative to the work that it did, which inevitably had an impact on its ability to undertake high-quality work.[109] Benoit Lallemand argued that because the ESAs were under-resourced, they relied on "very competent people" from the authorities in different Member States. Any decision to increase the ESAs' powers was therefore "a question of how much you are willing to delegate these sorts of powers to a European authority."[110]

89. Kern Alexander argued that the ESAs' independence would be enhanced by giving them their own line in the EU Budget independent of the Commission.[111] Michel Barnier thought that it would be logical for the ESAs to be fully funded by the institutions that they supervised.[112]

90. We asked the UK authorities for their view. David Lawton said that the FCA contributed significant resources through the various standing committees. The FCA was keen to see the ESAs be successful, and part of that meant ensuring they were not overwhelmed.[113] Andrew Bailey said that the ESAs were faced with "a blizzard of legislative implementation" and there was no question that this was placing a strain on resources. Nevertheless he was confident that this was a temporary problem given the scale of the post-crisis legislative agenda and that the ESAs would be sufficiently resourced in the long term.[114] The Minister did not believe that the ESAs were significantly under-resourced, but instead said that they needed to bed down against their own stated objectives of strengthening the quality of regulation and supervision.[115]

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[105] Q 248
[106] Q 179
[107] Q 246
[108] Q 225
[109] Q 196
[110] Q 92
[111] Q 36
[112] Q 108
[113] Q 237
[114] Q 266
[115] Q 284

### The ECB's relationship with the EBA

91. One specific issue raised by our witnesses was the nature of the EBA's relationship with the ECB, given the latter's growing prominence and powers under the Banking Union's Single Supervisory Mechanism (SSM) in particular.

92. Karel Lannoo warned of the danger of competition and overlap between the two bodies. In his view the EBA should be the standard-setter for the Single Market and the ECB one of the Single Market's supervisors.[116] Nicolas Véron predicted that the ECB would become a much stronger institution than the ESAs in advising on or producing technical rules because of Banking Union.[117] Douglas Flint said the ECB would become the "gorilla in the room" and that it would be a challenge for the EBA to exert authority over such a dominant institution.[118]

93. Andrea Enria said that the division of responsibilities between the EBA and the ECB should be clear.[119] Yet he conceded that "in the supervisory field, we are still in a sort of existential search for what our value-added could be to make sure that we have a level playing field and a common layer of practices between the ECB and the other authorities." He called for strengthened powers for the EBA in terms of transparency, common definitions and common aggregates in relation to stress tests, and to ensure greater consistency across Member States.[120]

### Conclusions and recommendations

94. In seeking to summarise this evidence, we were struck by the conclusion of Wim Mijs:

> "If we want the ESAs to play the role that we envisaged at Level 2, in flexibility and in calibration, we need to revisit the design. Either they need more resources, more autonomy and perhaps different leadership, or you may need to redefine their tasks to avoid them being put under such political pressure that they cannot do their work anymore."[121]

95. **The three European Supervisory Authorities have endured a baptism of fire since their inception in 2011. They have been responsible for much good work in responding to the challenges of the crisis and the substantial legislative reform programme that has ensued, in particular in upholding the Single Market in financial services and developing the single rulebook. Nevertheless they are hampered by a number of fundamental weaknesses:**

- **A discernible lack of authority *vis-à-vis* the other EU institutions, the ECB, and national competent authorities such as the FCA and PRA;**

[116] Q 68

[117] Q 54

[118] Q 209

[119] Q 182

[120] Q 183

[121] Q 91

- **Insufficient independence from the Commission;**
- **Marginal influence over the Level 1 legislative process;**
- **An inadequate funding structure;**
- **A significant lack of resources given the scale of the tasks they have been asked to perform;**
- **Inadequate resources to fulfil effectively their consumer protection obligations;**
- **Insufficient time to ensure effective and wide-ranging consultation in relation to their Level 2 responsibilities;**
- **Insufficient flexibility in the application of legislation and in the correction of legislative errors. Such inflexibility seriously undermines the effectiveness of the legislative framework. Given the scale and complexity of the reforms, the time pressure under which they were adopted, and the rate at which markets develop, an efficient and flexible means for the correction of errors and the finessing of rules is of critical importance.**

96. **We welcome the Commission's report on the ESAs, and its recognition of the need for short-term and medium-term improvements in their function. While we do not necessarily endorse all of its proposals, we call on the Commission to take forward as a priority its programme of reforms. In particular, we believe that there is a strong case for:**

- **Enhancing the ESAs' input and provision of technical support and expertise in the Level 1 discussions. As a starting point the Commission should, as a matter of practice, seek a formal opinion from the ESAs on its Level 1 proposals. Such input would provide a means to improve legislative proposals and to ensure that the ESAs were able to understand the intentions that lay behind them. We see no good reason why the ESAs should be excluded from Level 1 discussions;**
- **Enhancing the ESAs' involvement in the development of Commission Impact Assessments, and requiring the ESAs to provide *ex post* assessments of the extent to which legislation meets its regulatory objectives;**
- **Increased resources devoted to fulfilment of the ESAs' consumer protection objective;**
- **In the medium term, development of a new funding mechanism via the financial industry, which will in turn help finance a significant increase in staff resources for the three ESAs. In the short term, the inclusion of ESA funding as a separate line in the EU Budget in order to underline the autonomy of the ESAs.**

97. **We also call for the development of a more flexible expedited mechanism whereby the ESAs can, subject to appropriate scrutiny**

**and accountability mechanisms, propose technical amendments to legislative texts to take account of technological developments or to correct errors. One such mechanism could be to give the ESAs the formal right and obligation to write to the Commission, copied to the Council and the European Parliament, pointing out any legislative defects or errors, and the textual amendments that they would wish to be fast-tracked to correct such defects.**

98. **A number of simple reforms will help the Level 2 process more generally, including ensuring that the ESAs are allowed at least 12 months to complete their Level 2 responsibilities, with flexible rather than fixed implementation deadlines set out in the Level 1 text, in turn providing sufficient time for consultation with practitioners and regulators on the detail of Level 2 measures. It is also essential that an effective mechanism is put in place which, subject to appropriate accountability mechanisms, facilitates the making of technical amendments to complex Level 2 rules in as prompt a fashion as possible.**

99. **The ESAs also have a role to play in strengthening their own effectiveness. We encourage the ESAs to enhance their consultation procedures and their engagement with smaller, less well-funded and less visible sectors and industry groupings, including, but not limited to, consumer groups.**

# CHAPTER 4: THE EU FINANCIAL REGULATORY FRAMEWORK IN DETAIL

## Introduction

100. This chapter takes a thematic approach, examining how selected EU crisis-era financial regulation measures contributed to the objectives set by EU legislators. In particular, it assesses:

- The effectiveness of the single rulebook in supporting financial stability, market transparency and effective consumer protection;
- Whether there are any inconsistencies in the regulatory framework;
- Whether there is consistent application and enforcement of the new regulatory rules across the EU;
- Whether there has been effective co-ordination and tailoring of the various legislative reforms to specific segments of financial markets;
- Whether legislation has been proportionate in its effect;
- The costs for industry and end users of the new regulatory framework;
- Whether the process of reforming the regulatory framework has been excessively politicised.

## Assessing the effectiveness of the single rulebook

101. We begin by assessing the effectiveness of the single rulebook in terms of supporting financial stability, market transparency and consumer protection.

### *Financial stability*

102. The Capital Requirements Directive IV (CRD IV), the Capital Requirements Regulation (CRR) and the Bank Recovery and Resolution Directive (BRRD) are at the core of the new EU regime governing financial stability. These preventative measures are designed to decrease the likelihood of a financial institution failing.

103. Several witnesses commented that such stability measures did not adequately address problems relating to the resilience of financial markets, particularly with respect to the resolution of large and complex financial institutions.[122] Lucia Quaglia told us there was doubt over the extent to which globally significant financial institutions that were deemed 'too-big-to-fail' could be wound down in an orderly fashion without recourse to the Sovereign and most importantly, the taxpayer.[123] Benoit Lallemand said that capital requirements did not go far enough, as the related capital calculations, which rely on internal banking models, remained a weakness of the regime. He was

122 See for instance Q 85 (Benoit Lallemand and Wim Mijs), Q 193 (Sally Dewar) and written evidence from Professor Alistair Milne (FRF0016).

123 QQ 26, 28, 34

concerned about the complexity of the new bail-in[124] and resolution operations, given the interconnectedness of the financial system.[125] Wim Mijs said that the BRRD appeared to be inadequate on an international level.[126]

104. On the other hand, Sharon Bowles said that a financial failure was less likely to happen because higher capital buffers introduced under the CRD IV/CRR made bail-in less likely (a new bail-in regime applies under the BRRD).[127] Kern Alexander argued that the Basel III programme would lead to greater financial stability because it incentivised banks to raise higher equity capital.[128]

105. David Rule asserted that there were several means of assessing the adequacy of bank capital, including stress tests, risk-based capital requirements and the leverage framework. He warned that "banks will always optimise to the lens that you focus on." Mr Rule said that while the overall bank regulation regime was more complicated, "it is coherent and more robust none the less."[129] Douglas Flint felt that the various measures had reduced the probability of failure, but were ultimately concerned with distributing rather than eliminating the burden of failure. Ultimately, the burden rested with society as a whole.[130]

106. Sir Jon Cunliffe argued that more work was needed to ensure that the resolution framework was consistent with State Aid guidance.[131] The Financial Markets Law Committee pointed out that legal uncertainty was likely to arise from the fact that "contractual bail-in provisions may not operate in the same way as statutory bail-in provisions under the BRRD."[132]

107. Kern Alexander stated that recapitalisation requirements could sit at odds with stress testing by regulators. He said that if banks "do not comply fully with the stress test the supervisor can require them to issue more capital, even though they may not be in violation of an EU rule on bank capital."[133]

108. The global 'too-big-to-fail' agenda being led by the FSB is central to current efforts to strengthen financial stability. The FSB's related Systemically Important Financial Institutions (SIFI) Framework is designed to address the 'too-big-to-fail' risk by reducing the probability and impact of SIFI failure. It contains requirements relating to: the assessment and designation of SIFIs;[134] additional SIFI loss absorbency; increased supervisory intensity; more effective resolution; data gaps; and the strengthening of core financial market infrastructures. Progress on the development and implementation of

124 'Bail-in' relates to the process under which the losses of a financial institution are written down by being imposed on shareholders and bondholders. The write-down/allocation of losses takes place under a pre-set order and is designed to rescue/recapitalise the institution.

125 Q 85

126 *Ibid.*

127 Q 19

128 Q 40

129 Q 258

130 Q 205

131 Q 257

132 Written evidence from the Financial Markets Law Committee (FRF0023)

133 Q 35

134 30 Global Systemically Important Banks (G-SIBs) and nine Global Systemically Important Insurers (G-SIIs) have been designated.

the SIFI Framework is monitored by the FSB and is the subject of FSB peer review. The FSB's current work on the resolution element of the Framework, for example, includes proposals on the total loss absorbing capacity of G-SIBs,[135] cross-border recognition of resolution actions and supervisory information sharing and cooperation.[136]

109. **Although it is recognised that issuance of bail-inable debt may raise the cost of funding for some institutions, the removal of an explicit bail-out guarantee that eliminates moral hazard should lead to greater market discipline. Furthermore, the expected short-term bank funding costs could be offset by a reduction of bank risk and may therefore lower the cost of bank funding in the future.**

110. **We welcome efforts to improve the stability and resilience of the financial sector. We note in particular the Capital Requirements Directive, Capital Requirements Regulation and the Bank Recovery and Resolution Directive, which are designed to reduce and mitigate the effects of the failure of a financial institution. Yet such reforms are only able to contain risk rather than eliminate it.**

111. **We are also concerned that reforms designed to solve the problem of 'too-big-to-fail' have still not been sufficiently addressed. We are only now witnessing the early fruits of international discussions on this issue. In the meantime, the regulatory framework continues to leave taxpayers at risk of the failure of a large and complex financial institution.**

112. **More needs to be done to enhance the transparency and comparability of financial assets to allow international, European and national competent authorities properly to regulate and supervise financial institutions, providing confidence to financial market participants and end users. The EU and global partners must remain alert to maintaining the resilience of the financial system to new and emerging risks. To that end we welcome the work of the FSB in seeking to tackle the 'too-big-to-fail' dilemma.**

*Market transparency*

113. Witnesses stressed the importance of transparency in the financial system. The Centre for International Governance Innovation stated that "one of the many shortcomings that contributed to the financial meltdown was the uncontested buildup of systemic risk stemming from the lack of transparency, coupled with ineffective supervision of the banking sector which exposed its lack of resilience to shocks."[137]

114. Several legislative measures, in particular MiFID II, MiFIR and EMIR were designed to enhance transparency and resilience in securities and derivatives markets. In particular, MiFID II and MiFIR extend the transparency requirements already applicable to the equity market to non-equity markets (including organised trading in bonds and derivatives), and apply

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[135] Global Systemically Important Banks.

[136] The FSB's Key Attributes for Effective Resolution (2011) are the 'umbrella' standards governing resolution.

[137] Written evidence from the Centre for International Governance Innovation (FRF0013)

transparency requirements to a wide range of organised trading venues beyond the particular regulated markets previously covered by MiFID I. EMIR additionally brings significantly greater transparency to the OTC derivatives market.

115. Verena Ross acknowledged that these reforms presented "a huge change and a huge challenge" in terms of creating a consistent transparency regime across the EU. She warned that "making everything transparent in a nanosecond to everyone could also harm some of the functioning of the markets. Getting that balance right is extremely difficult."[138]

116. On the other hand, Michel Barnier said that MiFID II could have been more ambitious on transparency requirements, both pre-trade and post-trade.[139] Our own report on MiFID II/MiFIR, written during the course of negotiations in 2012, was sympathetic to the Commission's aims of ensuring equivalence of market models and investors' access to relevant information and terms of trade. While the proposals relating to post-trade transparency were likely to be beneficial for investors and regulators, we warned that the pre-trade transparency reforms could be flawed. In particular, the different liquidity characteristics of different elements of financial markets meant that a one-size-fits-all approach to pre-trade transparency needed to be avoided.[140]

117. EMIR introduces transparency requirements for the OTC derivatives markets in Europe, and also includes clearing and related risk management rules such that counterparties can better manage their risks. The BBA highlighted in particular that principles of transparency were important to ensure that clients were well-informed and to create greater competition. They argued that EMIR, as well as earlier measures such as MiFID I, had provided both regulators and industry with powerful and effective tools with which to inform their decisions and enforce high standards of market conduct.[141]

118. Transparency is also a key issue in relation to the shadow banking sector. We explore this further in Chapter 7.

119. **A lack of understanding of the complexity of the financial sector and its interconnections was a key factor in the scale and depth of the financial crisis. The EU's efforts to promote transparency across the financial sector as a whole are therefore welcome. Having said that, it is important to acknowledge the markedly different characteristics of each sector of the market when applying transparency requirements. A flexible approach is needed to ensure that the right balance is struck between reaping the benefits of increased transparency and ensuring that the market is able to operate in an effective and efficient manner.**

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[138] Q 244

[139] Q 105

[140] European Union Committee, *MiFID II: Getting it Right for the City and EU Financial Services Industry* (2nd Report, Session 2012–13, HL Paper 28)

[141] Written evidence from the British Bankers' Association (FRF0015)

### *Consumer protection*

120. The EU's crisis-era reforms directed to strengthening consumer protection are contained, for the most part, in MiFID II, the PRIIPs Regulation, the Deposit Guarantee Schemes Directive, and the Insurance Mediation Directive (IMD) II proposal. As we explained in Chapter 3, the ESAs also have an obligation to ensure effective consumer protection.

121. Several witnesses cited the extensive new disclosure regime contained, for example, in MiFID II and the PRIIPs Regulation. While Sue Lewis was broadly positive about the package of measures, she said that they were likely to lead to the production of long and complex disclosures which were not optimal for end users. She cautioned that the reliance on disclosure tools in the consumer protection package "almost seems to be protecting the firm rather than acting in the interest of consumers."[142] Christopher Woolard said that disclosures could potentially be contradictory or quite burdensome and called for better disclosure design.[143] The Wealth Management Association argued that proposals by the European Parliament for retail consumers to sign and return Key Information Documents before investing in packaged retail investment products "could have seriously and needlessly damaged efficiency".[144]

122. The consumer protection package extends beyond disclosure to include distribution and related inducement rules. A number of witnesses commented on the new MiFID II distribution rules which, for example, prohibit commissions in the independent investment advice context. Wim Mijs noted that the approach to consumer protection had been modernised in MiFID II, which introduced a new approach to inducements and had made costs more transparent.[145] Benoit Lallemand noted, however, that the interpretation and implementation of the new inducement measures would be a challenge.[146] Kay Swinburne MEP expressed disappointment that MiFID II had not reflected the more extensive UK Retail Distribution Review reforms more closely. She explained, for example, that the MiFID II inducement regime did not include a ban on commissions across all sales channels, but only extended such a ban to independent advisers.[147]

123. The consumer protection package includes the new deposit protection regime introduced by the 2014 Deposit Guarantee Schemes Directive; bank deposits are also protected by the 'bail-in' rules under the BRRD. Many witnesses were positive about these changes.[148] Karel Lannoo explained that the 2014 Deposit Guarantee Schemes Directive enhanced the harmonisation of national and some private deposit insurance schemes in Member States, including by imposing pre-funding requirements on schemes.[149] Sharon Bowles said that UK consumers were better off because under the

142 Q 216

143 Q 232

144 Written evidence from the Wealth Management Association (FRF0014)

145 Q 82

146 Q 83

147 Q 141

148 See for instance Q 19 (Sharon Bowles), Q 82 (Wim Mijs) and written evidence from the British Bankers' Association (FRF0015).

149 QQ 62–63

harmonised rules the guarantee level was raised to £85,000.[150] Nevertheless, it meant that taxpayers would be in the line of fire "because it is their pension funds that would be bailed-in."[151]

124. Colin Tyler argued that bail-in rules were not yet fully clear. He raised concerns over the shortfall for a pension scheme that could arise as a result of a bail-in operation. He said that the changes of introducing bail-in as well as the deposit guarantee scheme meant that retail depositors would be ranked ahead of wholesale depositors. This meant that "cash on a day-to-day basis may well become hotter than it used to be. The slightest whiff of a problem with a bank will mean that that will move very fast."[152] Wim Mijs was unsure how bail-in would work in practice and whether senior debt could be bailed in.[153]

125. More generally, the BBA argued that while consumers benefited from increased stability through the banking system, this came at the cost of lower competition for deposits and lower levels of return.[154] Simon Gleeson said that Basel III and Solvency II were beneficial to consumers because they required institutions to hold more capital, making them more robust. He said that "what the consumer wants more than anything else is access to a working system tomorrow morning and confidence in it." He believed that the BRRD had the effect of increasing consumer confidence that they would be repaid if an institution failed, although this was not consumers' primary concern.[155]

126. The Financial Services Consumer Panel complained that there was a lack of direct consumer representation during the preparation of new legislative proposals.[156] The IRSG agreed that the needs of end users were not sufficiently taken into account during the policymaking process.[157]

127. There is also a trade-off between choice and protection in such reforms. For example, MiFID II restrictions on the type of investment products which can be sold execution-only[158] may enhance investor protection for many retail investors who are best served by the most straightforward products. Investor choice may, however, be reduced. In particular, more sophisticated retail investors may lose the opportunity to engage in higher-risk/higher-return investments.

128. As we explored in Chapter 3, the ESAs have key responsibilities in relation to consumer protection and have established internal structures to deal with consumer protection issues. The 2014 review of the European Supervisory

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150 Q 19

151 Q 2

152 Q 221

153 Q 85

154 Written evidence from the British Bankers' Association (FRF0015)

155 Q 48

156 Written evidence from the Financial Services Consumer Panel (FRF0007)

157 Written evidence from the International Regulatory Strategy Group (FRF0017)

158 That is, without advice.

Framework suggested that ESAs better promote consumer and investor protection issues and make full use of available powers enshrined to them.[159]

129. **We welcome the reforms that have been introduced to strengthen consumer protection. Nevertheless, there are some flaws in the design of the new consumer protection tools, rendering them less effective. Excessively detailed disclosure requirements are unlikely to benefit consumers. Bans on inducements need to be tightly defined so that it is not possible to circumvent the rules. The trade-off between choice and protection which is implicit in the reforms must also be acknowledged. The impact of the new rules on the retail market should accordingly be carefully monitored by national regulators and the ESAs.**

130. **We welcome the enhanced protection for consumer deposits in the event of a bank failure contained in the Bank Recovery and Resolution Directive. Yet we repeat that such risks can only be contained rather than eliminated. It remains to be seen how effective such protection will prove to be in the event of a further systemic crisis in the banking sector.**

### Inconsistent rules in the regulatory framework

131. Sir Jon Cunliffe told us that it was not yet possible to know how the different pieces of the regulatory framework would fit together.[160] Kern Alexander and Lucia Quaglia each thought that gaps in the regulatory framework were more likely to be identified than inconsistencies.[161] The IRSG suggested, however, that there was a contradiction between the impact of some regulatory measures and the desire of policymakers to promote growth.[162]

132. Our witnesses identified specific inconsistencies between legislative dossiers, in particular with regard to definitions. A notable case was the definition of derivatives. Anthony Browne explained that a 'derivative' was defined in MiFID I/MiFID II, and that this definition then supported other EU measures, but the way in which that framework definition related to EMIR's detailed requirements for derivatives was not clear: "The result is … different types of derivatives that are affected by EMIR in different national jurisdictions."[163] The Financial Markets Law Committee similarly stated that ESMA had told the Commission that "the different transpositions of [MiFID] mean that there is no single commonly adopted definition of derivative."[164] Accordingly, Colin Tyler noted that a foreign exchange forward[165] was treated differently in the UK compared to the rest of the EU.[166]

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159 *Report on the operation of the European Supervisory Authorities*

160 Q 257

161 Q 34

162 Written evidence from the International Regulatory Strategy Group (FRF0017)

163 Q 190

164 Written evidence from the Financial Markets Law Committee (FRF0023)

165 A form of hedging contract which locks in an exchange rate for a future purchase or sale.

166 Q 219

133. Inconsistency also arose with respect to consumer protection. Sue Lewis pointed out that Alternative Dispute Resolution (ADR) requirements, for example, were not being consistently applied across the relevant directives: "It is missing from PRIIPs, although it has been incorporated into MiFID." She was concerned that consumer protection was weaker in some EU Member States, as decisions by ADR entities were non-binding.[167] Sue Lewis highlighted that key principles, however, were largely consistent except for the 'duty of care' principle. While there was a duty of care principle in MiFID I/II, it was not included in the PRIIPs Regulation, the Payment Accounts Directive or the Prospectus Directive.[168]

134. Inconsistencies were also highlighted in the new disclosure regime. Christopher Woolard highlighted the inefficient interplay between MiFID II, IMD II and the PRIIPs Regulation. He explained that, due to the different characteristics of European domestic markets, some products would be labelled as 'insurance', and others not, even when the underlying product was the same.[169] Aberdeen Asset Management pointed out that MiFID II addressed investment products and IMD II set the framework for selling insurance products that included an investment element: "These can be very similar products in practice but inconsistency between the two directives has the potential for customer confusion and increased risk of regulatory arbitrage."[170]

135. Andrea Enria drew attention to the problems of ensuring the consistency of the single rulebook across products and different financial sectors. He explained that the EBA collaborated with ESMA and EIOPA to provide a more cross-sectoral approach, particularly in the areas where the ESAs were given a joint mandate. By way of example, he highlighted the ESA work agenda on the PRIIPs Regulation with respect to the summary disclosure required for products that were similar in function but could be packaged as either banking or insurance.[171]

136. Some inconsistencies may arise from the Commission's working methods. Sharon Bowles argued that while the Commission did seek to achieve consistency, its approach in drafting new legislation tended to be to follow its original proposals in previous, related measures rather than the ultimate outcome of negotiations on them. She cited as an example the way in which time limits for approving regulatory technical standards and delegated acts had to be changed in every single piece of legislation.[172]

137. **We acknowledge the concern of a number of witnesses that internal inconsistencies and gaps are a troubling feature of the single rulebook. Given the complexity and reach of financial regulation, we also acknowledge that some internal inconsistency may be unavoidable. But where inconsistency and incomplete coverage becomes a risk to the Single Market, remedies must be found.**

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[167] Q 218 and supplementary written evidence from the Financial Services Consumer Panel (FRF0028)

[168] Q 218

[169] Q 232

[170] Written evidence from Aberdeen Asset Management (FRF0022)

[171] Q 178. See also Q 245 (Verena Ross).

[172] Q 16

138. **We call on the Commission to undertake a detailed audit of the most serious inconsistencies and gaps within the single rulebook, and to take steps to remove any inconsistencies that create a risk of regulatory arbitrage or significantly increase cross-border transaction costs. We also encourage the ESAs in their supervisory work to continue to be mindful of the need to identify unnecessary or damaging inconsistencies.**

### Ensuring consistent implementation and enforcement of rules

139. In addition to the internal consistency risks noted above, national implementation and related enforcement problems repeatedly came to light. Michel Barnier told us that the rules were the same for every one of the 28 Member States but that differences arose in how the rules were implemented.[173] Verena Ross said that ESMA would try to ensure that MiFID II and MiFIR rules (for example) were consistently implemented at national level. Yet inconsistencies of implementation could arise because of various waivers and exemptions. Some market players would accordingly seek to exploit the different rules.[174]

140. National inconsistencies can shape EU-level action. Karel Lannoo thought that inconsistency in supervisory practice was a particular problem in relation to the reporting standards used by both the ECB and the EBA in the preparation of stress tests to assess the health of the financial system. He estimated that "around two thirds of the reporting of the banking system in Europe may not be harmonised".[175] Nicolas Véron explained that in terms of ECB supervision, the networks of independent national audit firms that supervise banks' national operations were not centrally integrated or regulated. He said that this was a "recipe for inconsistency of accounting practices, which will quickly become unworkable for the supervisor."[176]

141. More generally, Nicolas Véron said that the problem of inconsistency in implementation was due to a lack of enforcement. He argued that "the European Commission has enforcement powers that it has not used to the extent that it should have".[177] Simon Gleeson agreed.[178]

142. Andrea Enria said that maintaining flexibility in national implementation of the single rulebook meant that major differences in the interpretation of common standards were uncovered on a weekly basis. He gave the example of the discretion allowed with respect to the phasing in of new requirements under the CRD IV/CRR legislation. However he expressed hope that the review by international authorities of the implementation of Basel III would create an opportunity for the EU to remedy any inconsistencies.[179]

143. Much of this debate centred on whether it was more appropriate to use regulations or directives with regard to financial sector reforms.

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[173] Q 114

[174] Q 244

[175] Q 70

[176] Q 59

[177] *Ibid.*

[178] Q 58

[179] QQ 178, 183

144. The BBA drew a distinction between wholesale markets (which were by their nature cross-border and therefore required consistent rules for business in the form of regulations), and retail markets (which were characterised by consumers demonstrating a home-country bias and were subject to distinct cultural conditions and policy choices, where directives could be more appropriate).[180] The Wealth Management Association argued that directives were more suitable for the retail sector because of the unique national characteristics of their markets.[181] On the other hand, AFME argued that the uncertainty generated by Member States' flexibility in transposing legislative requirements justified the use of regulations wherever possible.[182]

145. Kern Alexander said that there were strong arguments in favour of a minimum harmonisation framework, with Member States allowed to compete on different levels of regulation above the minimum standard. Such an approach would argue in favour of the use of directives.[183] Karel Lannoo observed, however, that there was very little support in Brussels for such competition: "The straitjacket is enormously tight in the financial sector. Only a few directives are left."[184]

146. **New regulatory rules need to be consistently implemented and enforced across all Member States if the single rulebook is to be effective and the Single Market is to operate efficiently. We urge the Commission to step up its efforts to make full use of its enforcement powers.**

147. **There is a trade-off between ensuring complete consistency across the Single Market in the form of the single rulebook and ensuring that the specific characteristics of the markets of individual Member States are taken into account. In saying that, it is essential that discrepancies in implementation are contained so as to protect the Single Market by ensuring as much consistency across the EU as possible.**

### Ineffective co-ordination and tailoring of rules to specific areas of the financial markets?

148. Some witnesses argued that the reforms failed to respond to the needs and features of particular market segments. The end result was that the reforms could be disproportionate and generate unintended effects.

149. In terms of the bond markets, for example, witnesses warned that it was important to take account of the need for effective co-ordination of the CRD IV capital reforms, and tailoring of the MiFIR transparency reforms, given that bond market liquidity was potentially sensitive to these reforms. With respect to MiFIR, Verena Ross said that it was "extremely difficult" to achieve an effective balance between market transparency, market functionality and sufficient liquidity.[185] The IRSG urged ESMA and national

180 Written evidence from the British Bankers' Association (FRF0015)

181 Written evidence from the Wealth Management Association (FRF0014)

182 Written evidence from the Association for Financial Markets in Europe (FRF0012). See also Q 96 (Benoit Lallemand).

183 Q 41

184 Q 72

185 Q 244

regulators to calibrate the MiFIR transparency requirements appropriately to the features of the bond markets during the Level 2 process. They warned that inappropriate measures would damage the ability of a market maker to trade, negatively impacting liquidity.[186] Sir Jon Cunliffe added that liquidity in market-making did appear to have been reduced. But he said that the levels of liquidity seen before the crisis were illusory: "We are not going back to that. People will have to pay more for liquidity."[187]

150. Securitisation markets, considered to be less liquid than markets for other assets, have stagnated in light of the damaging role they were perceived to have played in the financial crisis. However, efforts are now being made by the Bank of England and the ECB to revive securitisations in the EU.[188] Witnesses told us that the sector needed to be restored with a careful combination of tailored regulatory measures. In particular, the difficulties caused by the patchwork of rules potentially applicable to securitisations were raised. Verena Ross noted that the requirements relating to securitisations set out in different pieces of legislation could cause potential contradictions.[189] Andrea Enria said that a joint taskforce had been established to consider all the rules that impact on securitisation, such as Solvency II, CRD, AIFMD and rules concerning credit rating agencies.[190]

151. Douglas Flint explained that the securitisation market had not been successfully revived so far because the regulatory regime, coupled with the need for liquidity, encouraged banks, insurance companies and pension funds to hold a greater proportion of their assets in liquid securities. He added that market making and trading operations in illiquid assets were constrained due to incoming and uncertain regulatory measures: "If we want the natural holders of long-dated illiquid assets to hold them, we also need to give them liquidity."[191] Wim Mijs added that the bundling of SME loans in securitisations needed to be transparent and of high quality. He cautioned that different rules in Member States made it hard to compare SME balances, hindering efforts to package them into large amounts interesting enough for institutional investors.[192]

152. AFME asserted that the regulatory treatment of securitisations needed to be urgently addressed. While some progress had been made, more needed to be done to encourage investors to return to the market: "Proper calibration of the BCBS's[193] securitisation framework, Solvency II and LCR[194] will be crucial in achieving this." AFME also noted that improvements to margin posting[195] and clearing obligations for securitisation swaps under EMIR would be welcomed, alongside the development of the 'high-quality

186 Written evidence from the International Regulatory Strategy Group (FRF0017)

187 Q 257

188 European Central Bank and Bank of England, *The impaired EU securitisation market: causes, roadblocks and how to deal with them* (2014): http://www.bankofengland.co.uk/publications/Documents/news/2014/paper070.pdf [accessed 9 January 2015]

189 Q 245

190 Q 179

191 Q 206

192 Q 89

193 Basel Committee on Banking Supervision.

194 Liquidity Cover Ratio.

195 Requirements to provide collateral such as securities or cash in order to limit counterparty risk.

securitisation' or 'qualifying securitisation' concept by the ECB and Bank of England.[196] The BBA shared these concerns, pointing out that the current capital treatment of securitised assets for real money investors (under Solvency II) remained a barrier to more direct participation from the buy-side.[197] Sharon Bowles acknowledged the existence of "good securitisation", but cautioned that it could lead to off balance sheet vehicles, contributing to the growth in shadow banking.[198]

153. We consider securitisation further in the context of Capital Markets Union, in Chapter 7.

154. **Good regulatory design requires that rules appropriately reflect the specific features of particular market segments. It also requires that where rules bearing on particular market activities, such as securitisation, are contained within a patchwork of rules, care is taken to ensure that such rules do not result in unintended effects. We call on the Commission to ensure that the crisis-era reform programme appropriately reflects the particular features of distinct markets and permits effective and safe securitisation.**

### A lack of proportionality?

155. Strong spill-over effects can be associated with the crisis-era reform programme. The asset management sector, for example, while not directly associated with the financial crisis, has been the subject of extensive reform under AIFMD and UCITS V. Furthermore, some of the evidence we heard suggested that smaller or more niche financial services were disproportionately affected by financial stability regulation designed to be implemented by large financial institutions and firms. The distinction between wholesale and retail markets[199] is relevant in this context.

156. EMIR introduces new requirements to improve the transparency of and reduce the risks associated with the derivatives market. EMIR also establishes common organisational, conduct of business and prudential standards for CCPs[200] and trade repositories. However, EMIR imposes requirements on all types and sizes of entities that enter into any form of derivative contract, including those not involved in financial services. It also applies indirectly to non-EU firms trading with EU firms.[201]

157. Several witnesses discussed the disproportionate impact of EMIR's risk management rules. Colin Tyler said that non-financial corporates' businesses

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[196] Written evidence from the Association for Financial Markets in Europe (FRF0012). See Bank of England and European Central Bank, *the case for a better functioning securitisation market in the European Union*, (May 2014): http://www.bankofengland.co.uk/publications/Documents/news/2014/paper300514.pdf [accessed 9 January 2015] for suggestions of high level principles of a 'qualifying securitisation'. The Bank of England and the European Central Bank suggest in their consultative document that a qualifying securitisation is a security where risk and pay-off can be consistently and predictably understood.

[197] Written evidence from the British Bankers' Association (FRF0015)

[198] Q 15

[199] See para 144 and Chapter 6.

[200] Central Counterparty Clearing Houses.

[201] Financial Conduct Authority, 'European Market Infrastructure Regulation (EMIR)—what you need to know' (November 2014): http://www.fca.org.uk/firms/markets/international-markets/emir [accessed 9 January 2015]

had been unnecessarily dragged into certain areas of financial regulation.[202] He explained that "in the case of derivatives, for example, only 10% of the market is really derivatives from non-financial corporates … it is hardly systemically important."[203] Professor Alistair Milne, Professor of Financial Economics, Loughborough University, highlighted that while the business models of major banks had changed to take on the implementation of regulatory reporting under EMIR, barriers to entry to the market for client services had increased accordingly: "This lack of competition raises the cost to non-financial corporates managing interest rate, foreign exchange, commodity price and other risks, with a real impact on final customers."[204]

158. Another example was cited by the British Property Federation, which stated that real estate funds were categorised as a financial counterparty under EMIR due to their use of derivatives, even though the use of derivatives by real estate funds was in large part for the hedging of commercial risks rather than for speculative purposes. Yet requiring such use of derivatives to be subject to EMIR's central clearing requirement, and imposing EMIR's margin requirements[205] made traditional hedging of this type more expensive. This rendered it potentially economically unviable, particularly for small real estate funds.[206] The Building Societies Association similarly stated that they were struggling to find clearing services at a reasonable cost for small building societies with uneconomic volumes of derivative clearing activity.[207]

159. Similar problems were reported in relation to AIFMD. The scope of AIFMD is broad and, with a few exceptions, covers the management, administration and marketing of alternative investment funds (AIFs). An AIF is a 'collective investment undertaking' that is not subject to the UCITS regime, and includes hedge funds, private equity funds, retail investment funds, investment companies and real estate funds, among others. AIFMD establishes an EU-wide harmonised framework for monitoring and supervising the risks posed by alternative investment fund managers and the AIFs they manage, and for strengthening the internal market in alternative funds.[208]

160. Several witnesses suggested that AIFMD's wide reach generated proportionality risks. We heard, for example, that EU legislators had insufficient understanding of the industry before the Directive's development. Accordingly, some rules had a disproportionate impact.[209] The British Property Federation, for example, stated that AIFMD requirements "apply awkwardly to real estate funds, whose business model and investment and risk management processes are very different."[210]

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202 Q 215

203 Q 219

204 Written evidence from Professor Alistair Milne (FRF0016)

205 Requirements for collateral (cash or securities) to be provided to protect against counterparty risks.

206 Written evidence from the British Property Federation (FRF0008)

207 Written evidence from the Building Societies Association (FRF0004)

208 Financial Conduct Authority, 'Alternative Investment Fund Managers Directive (AIFMD)' (December 2014): http://www.fca.org.uk/firms/markets/international-markets/aifmd [accessed 9 January 2015]

209 Written evidence from the British Private Equity and Venture Capital Association (FRF0010)

210 Written evidence from the British Property Federation (FRF0008)

161. Similar issues arose in relation to the Capital Requirements Directive (CRD IV) and Regulation (CRR). These measures aim to reduce the negative effects of firms failing by ensuring that they hold enough financial resources to cover the risk associated with their business. The Directive and Regulation have also brought in a new EU-wide supervisory reporting framework for Financial Reporting (FINREP) and Common Reporting (COREP).[211]

162. Some witnesses were concerned about the proportionality of the CRD IV/CRR regime. The BVCA argued that the CRD IV reporting requirements, while necessary for banks given the systemic risks posed to financial stability, were wholly inappropriate for the private equity and venture capital industry. They argued that "the failure of much EU level financial services legislation to differentiate appropriately between different sectors means that firms are often significantly affected for no discernible reason." The costs of reporting requirements were "wholly disproportionate to the value which will be derived from such additional reporting."[212] Small deposit takers and investment firms had also been significantly affected.[213]

163. On the other hand, the Building Societies Association congratulated the EU for understanding and embedding the co-operative banking model in EU regulation.[214]

164. **Smaller firms, some financial services providers (including certain asset managers) and non-financial firms have been disproportionately affected by EMIR, AIFMD and CRD IV/CRR. Inappropriate definitions and requirements have been put in place which have significantly increased the operational costs for Real Estate Funds, Private Equity Funds and Venture Capital Funds in particular. This demonstrates the dangers of a lack of proportionality in financial regulation, and the need to keep in mind the specific features of the financial sectors in question. We repeat our call for better quality Impact Assessments before further significant reforms are introduced.**

### Assessing the costs of regulatory reform

165. Many have argued that the costs of regulatory reform were more than outweighed by the risk of financial collapse that such reforms were designed to prevent. The European Commission estimated that between 2008 and 2012 a total of €1.5 trillion of State Aid was used to prevent the collapse of the financial system.[215] A number of our witnesses agreed. Andrew Bailey told us that he was "very dogmatic about the view that a stable financial system is the one that will best support growth in the economy."[216] Sir Jon Cunliffe added that well-capitalised banks could lend, whereas banks in

211 Financial Conduct Authority, 'CRD IV' (December 2014): http://www.fca.org.uk/firms/markets/international-markets/eu/crd-iv [accessed 9 January 2015]

212 Written evidence from the British Private Equity and Venture Capital Association (FRF0010)

213 Written evidence from the Building Societies Association (FRF0004) and written evidence from the Wealth Management Association (FRF0014)

214 Written evidence from the Building Societies Association (FRF0004)

215 *A reformed financial sector for Europe*

216 Q264. See also Q 34 (Professor Kern Alexander).

capital preservation mode would not.[217] It is also the case that the public outcry which the financial crisis generated meant that the costs of the reforms, even if their impact was more fully understood at the time, was a secondary political consideration when set against the need to be seen to be taking action.[218]

166. Nevertheless, some witnesses raised concerns about the immediate costs of regulatory reform, in particular the costs for industry and consumers of regulatory compliance. The Wealth Management Association noted KPMG estimates that wealth management firms spent 10–20% of their turnover on regulation.[219] JP Morgan stated that 13,000 employees worldwide were added to support global regulatory, compliance and control efforts across the firm between 2012 and the end of 2014. $2 billion was spent in additional expenses on control efforts between 2012 and 2014, and $600 million on technology focused on the regulatory and control agenda.[220] AIFMD, in particular, came in for criticism for imposing disproportionate costs on the asset management sector, with HM Treasury noting the costs it had generated.[221]

167. Kern Alexander acknowledged that, in the longer term, "the new cost of regulation might inhibit the taking of certain risks that could be beneficial for the financial system."[222] Alistair Milne also pointed to compliance costs and the inhibiting effect on competition and the supply of risk finance.[223] Colin Tyler agreed that regulatory uncertainty was discouraging long term investment decisions.[224] Standard Life provided evidence that legislation, in the form of Solvency II, had left insurers unable to plan ahead due to regulatory uncertainty.[225] Aberdeen Asset Management stated that regulatory costs were passed on to end users.[226]

168. On the other hand, Kern Alexander said that it was almost impossible to calculate costs with precision: "Measuring all that out is really not practical in a policy sense, but we should not lose sight of the overall principle that we should have benefits from financial regulatory reforms."[227] AFME welcomed the European Commission's 2014 Economic Review of the Financial Reform Agenda. However they stressed that further assessment was needed to ensure that the right balance was struck between the costs and benefits of the reforms.[228]

169. **It is important to acknowledge the public outcry which the financial crisis generated and the popular and related political support for reform. It is also the case that, in principle, a stable and well-**

217 Q 264

218 On the political context of the reform agenda, see for instance Q 256 (Sir Jon Cunliffe).

219 Written evidence from the Wealth Management Association (FRF0014)

220 Written evidence from JP Morgan (FRF0026)

221 Written evidence from HM Treasury (FRF0029)

222 Q 34

223 Written evidence from Professor Alistair Milne (FRF0016)

224 Q 224

225 Written evidence from Standard Life (FRF0024)

226 Written evidence from Aberdeen Asset Management (FRF0022)

227 Q 34

228 Written evidence from the Association for Financial Markets in Europe (FRF0012)

**regulated financial market should lead to economic prosperity, creating growth and jobs. We are concerned that the compliance costs of such a vast set of regulatory reforms may have been underestimated, and that consequently their value for money was not properly assessed. It seems also that the knock-on consequences for the flow of credit to the real economy and for costs for end users, as well as the chilling effect on competition, were not taken sufficiently into account.**

170. **The problems that have been encountered underline the vital need for effective Impact Assessments, both during the legislative process and post-implementation, taking full account of the predicted and actual costs of regulatory reform.**

## The politicisation of regulation

### *Overview*

171. Several witnesses (including, unsurprisingly, many representatives of the financial sector that were affected by the reforms) criticised what they perceived as excessive politicisation of the regulatory reform agenda. Nicolas Véron said that "European policymakers have been very slow to reach an assessment of the crisis that would not be massively tainted by denial, blame-shifting and finger-pointing to outsiders. This has driven misguided reactions to the crisis from the beginning until now".[229] Simon Gleeson noted that the worst examples of poor legislation, such as the credit rating agencies regime, and the CRD IV bank bonus rules, were all "primarily politically driven" and "populist politics very rarely results in first-class regulation." Nevertheless, such "obvious errors" were only a small percentage of the total.[230]

172. Sir Jon Cunliffe stated that when the crisis erupted, "there was an outburst of public anger and dissatisfaction and a real political impetus to tackle … hot button issues" like AIFMD, hedge funds and credit rating agencies. This had not happened only in the EU and was "a natural societal and then political response to a very, very bad crisis." His conclusion was that early legislation "overshot … [but] when the regulators had a bit more time and a bit more space to take the reform programme forward, I think it did get better."[231]

173. The proposals most frequently cited by our witnesses as examples of excessive politicisation were:

- The Alternative Investment Fund Managers Directive (AIFMD);
- The Financial Transaction Tax (FTT);
- The remuneration rules under the Capital Requirements Directive (CRD IV), also known as the 'bank bonus cap'.

### *Case study one: AIFMD*

174. AIFMD is one of the most contested and controversial of the EU's crisis-era reforms. It introduces a new harmonised regime governing (with a few

229 Q 48

230 *Ibid.*

231 Q 256

exceptions) all asset managers in the EU, apart from managers of UCITS funds. It accordingly has a very wide scope and captures an array of asset managers, from managers of large, systemically significant hedge funds to managers of small venture capital and property funds. Given the reach of the harmonised regulation imposed by the Directive (which includes transparency, risk management, remuneration, and liquidity rules), concerns have arisen that it fails to reflect appropriately the different levels of risk posed by different asset managers, and that it has imposed disproportionate costs on certain segments of the asset management sector. In particular, it has been suggested that it puts at risk the competitiveness of the EU asset management industry, and creates disincentives for third country funds and managers seeking to access the EU market.

175. This Committee's 2010 report on AIFMD, written while the legislative process was continuing, concluded that while many of the Directive's provisions were welcome, "if the Commission had followed its own Better Regulation principles, many of the shortcomings of the Directive could have been dealt with at a much earlier point." Specific issues included a 'one-size-fits-all' approach which failed to acknowledge the differences in how AIFs are structured and operate, and the need to ensure consistency with global arrangements in the regulation of fund managers, in particular in terms of the treatment of third country regimes.[232]

176. Some witnesses expressed strong opposition to AIFMD. Standard Life did not perceive any benefits in adding costs to Investment Trusts, given they survived unscathed from the crisis.[233] The BVCA argued that many provisions in the Directive were ambiguously drafted, leaving important concepts undefined and open to interpretation.[234]

177. Kay Swinburne MEP said that AIFMD was unnecessary, misguided, misplaced and did not achieve its overall objective.[235] She described AIFMD as the EU equivalent of the UK Dangerous Dogs Act, an oft-cited case of rushed and politically motivated legislation:

> "It was rushed in, and it was highly political in the middle of the storm of the crisis. It was easier to distract attention from some of the eurozone and sovereign debt crises that were happening at the time and go after those evil people who were short-selling government bonds and causing the sovereign crisis, seemingly."[236]

178. On the other hand Sharon Bowles defended AIFMD, noting that the UK did not vote against the legislation.[237]

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232 European Union Committee, *Directive on Alternative Investment Fund Managers* (3rd Report, Session 2009–10, HL Paper 48)

233 Written evidence from Standard Life (FRF0024)

234 Written evidence from the British Private Equity and Venture Capital Association (FRF0010)

235 Q 141

236 Q 142

237 QQ 7–8

### *Case study two: Financial Transaction Tax*

179. The Commission's proposals for a Financial Transaction Tax (FTT) were published in September 2011. The Commission set out five broad objectives behind the tax:

- To avoid fragmentation in the internal market for financial services, bearing in mind the increasing number of unco-ordinated national tax measures being put in place;
- To ensure that financial institutions make a fair contribution to covering the costs of the recent crisis and to ensure a level playing field with other sectors from a taxation point of view;
- To create appropriate disincentives for transactions that do not enhance the efficiency of financial markets, thereby complementing regulatory measures aimed at avoiding future crises;
- To create a new revenue stream with the objective of gradually displacing national contributions to the EU budget, resulting in a lesser burden on national treasuries;
- To contribute to the ongoing international debate on financial sector taxation and in particular to the development of an FTT at global level.[238]

180. This Committee has published two reports that were highly critical of the proposal. We argued that the FTT was unlikely to fulfil any of the Commission's objectives, and in fact could cause the EU economy significant harm, in particular by encouraging financial institutions to relocate outside the EU.[239]

181. After a number of Member States including the UK announced that they would not support an EU-wide FTT, 11 Member States decided in 2012 to take forward the proposal under the enhanced co-operation procedure. Yet this too was contentious, because, as this Committee has argued, the proposal could have deleterious consequences even for non-participants such as the UK. In light of this, the UK Government's decision not to seek to block the January 2013 Council decision authorising the use of the enhanced co-operation procedure, which we believe it could have and should have done, remains baffling. The FTT participants have yet to reach agreement on the form and scope of the tax, although they remain committed to the FTT coming into force from January 2016.

182. Several of our witnesses criticised the FTT proposal. The BBA and the City of London Office in Brussels argued that it could undermine economic growth and have a detrimental effect on consumers.[240] Sir Jon Cunliffe argued that ultimately the FTT contributed nothing to the objective of

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238 Proposal for a Council directive on a common system of financial transaction tax and amending Directive 2008/7/EC, COM(2011) 594

239 European Union Committee, *Towards a Financial Transaction Tax?* (29th Report, Session 2010–12, HL Paper 287) and European Union Committee, *Financial Transaction Tax: Alive and Deadly* (7th Report, Session 2013–14, HL Paper 86)

240 Written evidence from the British Bankers' Association (FRF0015) and Q121 (Elizabeth Gillam)

financial stability.[241] Colin Tyler stated that the FTT was "utter madness", and warned that it would have an adverse impact on pension funds financed by corporations, with costs therefore falling on the end consumer.[242] We concur with all of these arguments.

*Case study three: bank remuneration provisions*

183. The final case study relates to the remuneration rules under CRD IV, also known as the 'bank bonus cap'. Both CRD III and the original CRD IV proposals' remuneration measures derived from the internationally agreed FSB Principles and Standards for Sound Compensation Practices. They included requirements relating to strict limits on guaranteed bonuses and mandatory deferral periods for pay-outs. Subsequently, during the CRD IV negotiations, the European Parliament added a mandatory, EU-wide, 'cap' on variable pay at 100% of fixed pay to CRD IV (the 'bonus cap'). The final text enabled this provision to be increased to 200% subject to a shareholder vote.

184. This provision has proved highly contentious, including among our witnesses. Douglas Flint described it as a "retrograde step".[243] He, Kern Alexander and Andrew Bailey saw merit in the previous claw-back and deferral arrangements under CRD III, which provided an appropriate incentive device.[244]

185. The UK Government has consistently opposed the measure, arguing that there was no evidence that it would discourage excessive risk-taking, and that it would instead backfire and lead to an increase in base salaries (and thus fixed costs) at banks. The Government also argued that EU-based banks would be placed at a competitive disadvantage through being forced to apply these rules on pay globally, and that they would make it harder to claw back bankers' pay when necessary.

186. In September 2013 the Government launched a legal challenge in the Court of Justice of the European Union (CJEU) against the bonus cap on the following six grounds:

- The contested provisions had an inadequate treaty legal base;
- The contested provisions were disproportionate and/or failed to comply with the principle of subsidiarity;
- The contested provisions had been brought into effect in a manner which infringed the principle of legal certainty;
- The assignment of certain tasks to the EBA and conferral of certain powers on the Commission was *ultra vires*;
- The identified disclosure requirements in the Capital Requirements Regulation offended principles of data protection and privacy under EU law; and

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[241] Q 256

[242] Q 215

[243] Q 206

[244] *Ibid.*, Q 34 (Professor Kern Alexander) and Q 262 (Andrew Bailey)

- To the extent that Article 94(1)(g) was required to be applied to employees of institutions outside the EEA, it infringed Article 3(5) of TEU and the principle of territoriality found in customary international law.

187. On 20 November 2014, the Advocate-General to the Court of Justice published his Opinion on the challenge. Of the six grounds of challenge he found the first, on treaty base, to be the most cogent, but stated that ultimately all six pleas should be dismissed. While the Government continued to believe that its legal arguments had merit, it nonetheless decided to withdraw its legal challenge. The Government stated that it would now work with the Bank of England and international standard-setting bodies such as the FSB, to consider steps to mitigate risks to financial stability arising from higher fixed costs at banks resulting from higher salaries.[245]

*Recommendation*

188. **We note the assessment of our witnesses that there were a few examples of excessive politicisation of the regulatory framework. Given the ramifications of the crisis, it is understandable that some elements of the new EU financial sector regulatory framework were in part the result of political pressures to take prompt action, and/or to make the financial sector pay for the crisis. Such legislation runs the risk of being disproportionate in its application and economically damaging. Once again, this makes the case for rigorous Impact Assessments at each stage of the legislative process.**

[245] Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, to Lord Boswell of Aynho, Chairman of the House of Lords European Union Committee, 8 December 2014

# CHAPTER 5: THE INTERNATIONAL REGULATORY AGENDA

## Introduction

189. The relationship between the EU's financial sector regulatory framework and the international regulatory agenda was another key issue. Box 4 sets out the system of international standards on financial sector regulation.

**Box 4: International standards on financial sector regulation**

The G20 agenda was initially agreed in the 2008 G20 Washington Action Plan[246] and expanded in subsequent key summits, including the April 2009 London Summit and the September 2009 Pittsburgh Summit.[247] The original Washington Action Plan was based on 47 recommendations organised under the general themes of: strengthening transparency and accountability; enhancing sound regulation (including with respect to prudential oversight and risk management); promoting integrity in financial markets; reinforcing international co-operation; and reforming international financial institutions. The subsequent Pittsburgh Summit reflected the Washington Action Plan in calling for reforms with respect to: building high quality capital and mitigating procyclicality (including through countercyclical capital buffers, strengthened liquidity risk requirements, and a leverage ratio); reforming compensation practices to support financial stability; improving the OTC derivatives markets; cross-border crisis management resolution for systemically important institutions; and the adoption of a single set of high quality global accounting standards.

The G20 agenda is accordingly high-level but also specific. It reflects in particular the initial reform agenda developed by the then Financial Stability Forum in 2008 and which was comprised of some 67 recommendations to be taken forward by the sectoral international standard-setting bodies (SSBs), such as the Basel Committee and the International Organization of Securities Commissions (IOSCO).

While the SSBs have adopted related standards, central steering of the implementation of this agenda has been provided by the Financial Stability Board (FSB), established in April 2009 following a G20 decision, and successor to the earlier Financial Stability Forum. The FSB has also adopted standards in support of the G20 agenda, particularly with respect to prudential regulation and the support of global financial stability. These SSB and FSB G20-driven standards then fall to local jurisdictions such as the EU to apply.[248] The FSB monitors progress on implementation, including through peer review.

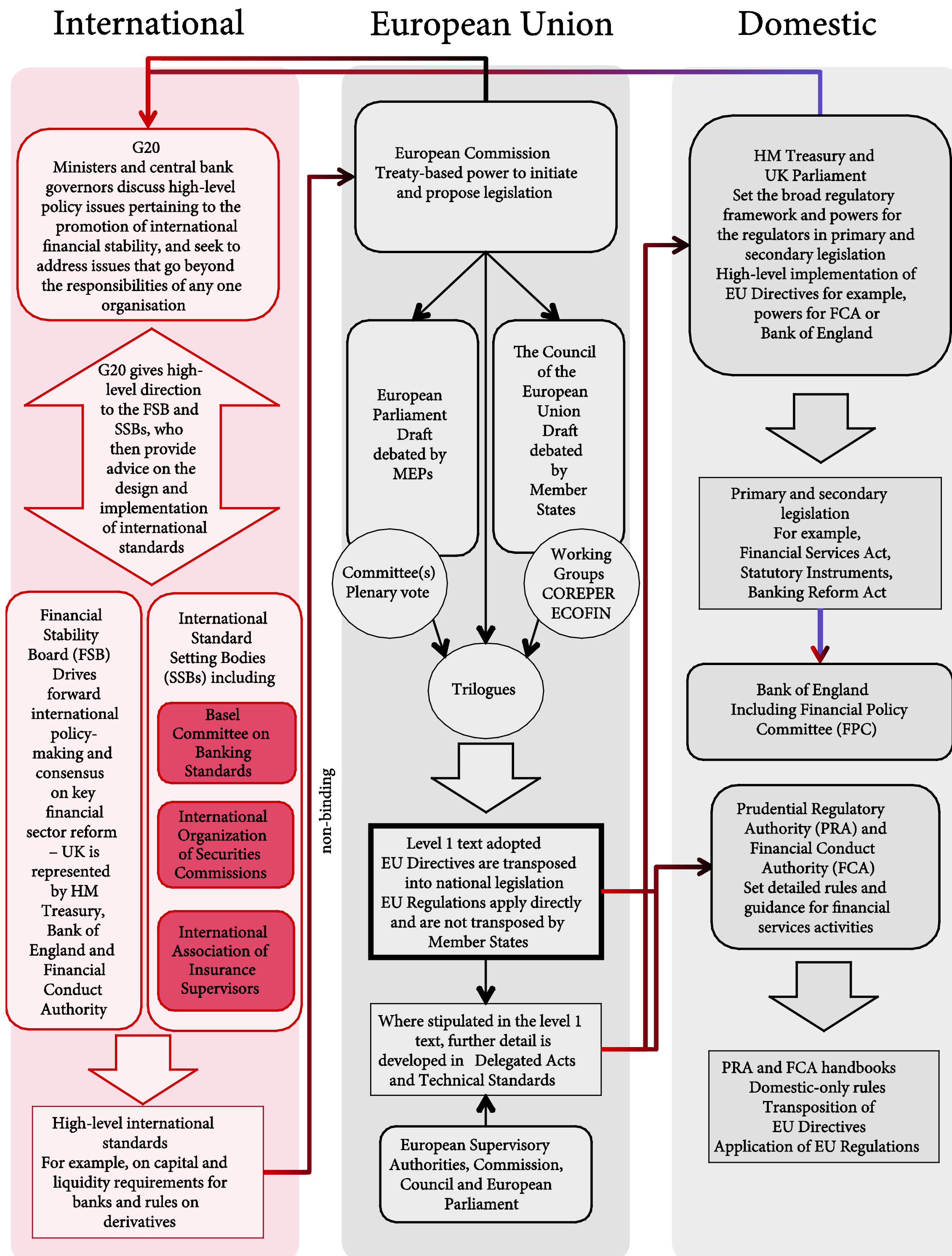
246 Washington G20 Summit, *Declaration of the Summit on Financial Markets and the World Economy*, November 2008

247 London G20 Summit, *Leaders' Statement on 'Strengthening the Financial System'*, April 2009, and Pittsburgh G20 Summit, *Leaders' Statement on 'Strengthening the International Financial Regulatory System'* September 2009

248 HM Government, *Review of the Balance of Competences between the United Kingdom and the European Union—The Single Market: Financial Services and the Free Movement of Capital*, (Summer 2014): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332874/2902400_BoC_FreedomOfCapital_acc.pdf [accessed 9 January 2015]

190. Figure 1 sets out in diagrammatic form the international, EU and UK financial services policy-making process.

**Figure 1: International, EU and UK financial services policy-making process**[249]




191. One of the issues we considered was whether the EU financial sector regulatory framework was consistent with the international regulatory agenda. The evidence received focused in particular on:

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249 *Ibid.* Source: HM Treasury.

- Examples of inconsistencies of approach;
- A comparison of the EU and US regulatory frameworks;
- The extent to which an EU-specific approach to regulation had been adopted, and whether this amounted to 'gold-plating';
- An assessment of the EU's third country regime;
- An assessment of the role of international standard-setting bodies.

### Inconsistencies of approach

192. Michel Barnier cited the treatment of derivatives as a notable case of international inconsistency.[250] Douglas Flint and David Lawton also stressed the importance of ensuring consistency in relation to derivatives.[251] Nicolas Véron believed that the blame laid with the G20 because it did not prescribe a global process to ensure initiatives would be aligned.[252]

193. Colin Tyler agreed that there was little consistency between the US and EU in regulating derivatives. He said it was inappropriate that non-financial corporates from outside the EU would need to post collateral, using their "own liquid resources for a non-productive purpose".[253] The margin requirements for non-centrally cleared derivatives were identified by AFME as susceptible to different transposition of rules between the US and EU, to the detriment of firms established and trading in the EU.[254] Alistair Milne drew attention to the costs of complying with reporting requirements for EU reporting entities in the US.[255]

194. Overall, Douglas Flint thought that, given the different characteristics of the EU, US and Asian markets, "the level playing field is one of these mirages that people talk about but is pretty impossible to contemplate."[256] Sir Jon Cunliffe said that it would be many years before there was perfect consistency between the rules in different jurisdictions. On the other hand, he conceded that regulatory arbitrage was a real danger. The important thing was to ensure there was confidence that things were being done to meet the same objectives in another jurisdiction even if not in exactly the same way.[257]

### Comparing the EU and US approaches

195. As some of these comments demonstrate, witnesses focused in particular on a comparison of the EU and US approach. Wim Mijs said that the US had approached regulation in a different way. Given the linkages of the American financial system with the City of London, there were dangers if the differences were too big.[258] Sharon Bowles asserted that the EU was largely

250 Q 111
251 Q 203 (Douglas Flint) and Q 232 (David Lawton)
252 Q 53
253 Q 219
254 Written evidence from the Association for Financial Markets in Europe (FRF0012)
255 Written evidence from Professor Alistair Milne (FRF0016)
256 Q 203
257 Q 263
258 Q 93

in line with what the US and the G20 were doing. However, she warned that Asian regulators were unlikely to be willing to go along with the EU-US consensus in the future.[259]

196. Several witnesses compared the EU's 'salami-slicing' approach to regulation (dealing with reforms in separate legislative proposals) with the US model, where regulatory reform of the financial sector has been implemented through the portmanteau Dodd-Frank Act.[260] Nicolas Véron argued that EU legislation was easier to correct than Dodd-Frank. On the other hand, he pointed out that there was more delegation to agencies in terms of the application of legislation in the US, whereas in the EU more detail was contained in the legislation itself.[261]

197. Lucia Quaglia argued that the provisions of the Dodd-Frank Act were similar to what the EU had been doing. She stressed the amount of consultation between US and EU authorities in seeking to avoid gaps and overlaps,[262] though Michel Barnier concluded that the EU was more interested in international collaboration than the US.[263]

198. In 2014, the European Union Committee published a report on *The Transatlantic Trade and Investment Partnership* (TTIP). The report considered the EU's calls (supported by the UK Government) for financial services to be included in TTIP, against strong opposition in the US. We concluded that:

> "In a negotiation between equals, it is in our view essential that one party should not be permitted to exclude a sector … that is clearly central to both economies. We therefore judge that the EU is right to press the US on the inclusion of financial services regulatory matters in TTIP. We were nonetheless struck by the vehemence of the US Administration's opposition, and found lukewarm support for the EU's stance among several of its Member States … We see no threat to financial and prudential regulation from the establishment of a more effective dialogue between EU and US regulators … We nonetheless judge that the UK and the European Commission will need to build a more compelling case for why the TTIP is the right vehicle for securing that outcome."[264]

### A specific EU approach?

199. We considered the extent to which an EU-specific approach to regulation had been adopted. Michel Barnier stated that while the majority of Europe's legislation derived from G20 requests, the EU had presented additional texts that responded to Europe's needs. He stressed that regulation needed to take account of the specific features of EU financial services, such as greater reliance on lending by the banking sector as opposed to capital markets.[265]

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[259] Q 17

[260] See for instance Q 141 (Dr Kay Swinburne MEP).

[261] Q 50

[262] Q 40

[263] Q 111

[264] European Union Committee, *The Transatlantic Trade and Investment Partnership* (14th Report, Session 2013–14, HL Paper 179)

[265] QQ 111–12

200. Mr Barnier noted that the proposed Benchmark Regulation was unique to Europe and was not a G20 agreed decision.[266] Despite this, AFME said that the development of the financial benchmark regulation was a good example of international co-operation. They argued that the FSB played an important role in co-ordinating national financial authorities and IOSCO positively contributed to the work on setting standards. [267]

201. We also note that the 2013 CRD IV/CRR applies the Basel III agreement to a wide range of investment firms as well as banks; contains additional capital requirements (including the requirement for certain macroprudential capital buffers); and contains detailed, EU-specific risk management, remuneration, and firm governance rules. Similarly, the credit rating agency regime is highly detailed as compared to the related G20 agenda, and contains institutional reforms specific to the EU context. We also note that, while some EU crisis-era measures, notably the Short Selling Regulation and AIFMD, are to some extent related to the G20 agenda, they have gone far beyond that agenda in imposing highly detailed and wide-ranging rules.

202. More generally, the IRSG argued that the EU had a tendency to modify and go beyond international standards.[268] Kern Alexander told us that there had been elements of gold-plating in Europe, with stricter regulations across most markets. Yet he did not believe that the EU would lose its comparative advantage in financial services.[269] Sir Jon Cunliffe added that an advantage of the EU approach was that when it got common rules right, this was enforced by European law, adding strength to international rules.[270] Benoit Lallemand told us that although he was not in favour of regulatory diversity, there might be occasions when different regulatory approaches might be justified to take account of circumstances in different parts of the world.[271]

203. Andrea Enria noted that in the past directives had left enough room to national authorities to deviate from international standards in a minimal way so as to adjust for their domestic markets. Under the single rulebook, EU regulations sought to take account of all such specificities, creating a risk that EU legislation deviated from international standards.[272]

204. Nicolas Véron considered that the EU had lagged behind global standards with Basel III, whereas it had led the way with Basel II. In his view, the EU had become less of a champion of global standards since the outbreak of the crisis.[273] Simon Gleeson was concerned that “we seem to be seeing an attempt not only to construct uniquely European solutions but to shut out the rest of the world as a result.” This was a particular problem in relation to derivatives and clearing arrangements. He described this as “the Colditz problem”:

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[266] Q 102

[267] Written evidence from the Association for Financial Markets in Europe (FRF0012)

[268] Written evidence from the International Regulatory Strategy Group (FRF0017)

[269] Q 40

[270] Q 263

[271] Q 94

[272] Q 178

[273] Q 53

"You start off trying to build a fortress but end up building a prison … the more you end up with quirky and slightly unique European approaches to particular problems, the more you find yourself constructing obstacles to business between Europe as a whole and the rest of the world".[274]

### The EU third country regime and its approach to equivalence

205. The EU's approach to third country access to the EU market was a particular concern for many witnesses. The BBA noted that the EU had taken a less liberal approach to third country access. An example given was the ban on EU bank branches clearing through non-EU CCPs unless the CCP was deemed to be equivalent by the European Commission and recognised by ESMA.[275]

206. Wim Mijs argued that, in principle, ensuring third-country access was beneficial. He stressed that access should be granted to non-EU countries that demonstrated equivalent rules, negotiated on the basis of mutual recognition.[276] The Wealth Management Association noted that third country access was less of an issue with regard to the retail market.[277]

207. Sharon Bowles said that issues concerning third country regimes "always seem to get pushed right to the end" of negotiations, with the danger that "some rubbish compromise" emerges.[278] Kay Swinburne MEP was dismayed that there was no single cross-cutting piece of work on third countries across EU financial legislation. She argued that an omnibus piece of regulation on third countries would iron out inconsistencies.[279]

208. The IRSG suggested that reciprocity should be avoided. They argued that the issue of mutual recognition and equivalence needed to be managed and agreed at the international level, with assessments based on compliance with international standards.[280] Other witnesses stressed the importance of ensuring that the EU's approach did not give rise to EU protectionism or to regulatory retaliation, restricting EU access to international markets.[281]

209. Michel Barnier asserted that the EU was not trying to promote extraterritoriality. Instead the objective was "common standards, interoperability of rules and equivalence when it comes to supervision". He stated that Europe needed to "keep its autonomy and sovereignty in this area." He explained that equivalence had the advantage for investors and financial institutions of avoiding duplicated supervision and regulation.[282]

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274 *Ibid.*

275 Written evidence from the British Bankers' Association (FRF0015)

276 Q 95

277 Written evidence from the Wealth Management Association (FRF0014)

278 Q 15

279 Q 156

280 Written evidence from the International Regulatory Strategy Group (FRF0017)

281 Written evidence from the British Private Equity and Venture Capital Association (FRF0010) and written evidence from Aberdeen Asset Management (FRF0022)

282 Q 113

### The role of international bodies

210. Some witnesses commented on the role of international bodies. These include:

- The FSB, which is responsible for steering the G20 agenda and adopts an array of related standards, notably in the financial stability and prudential sphere;
- The Basel Committee, which sets international bank capital, liquidity, and leverage rules;
- IOSCO, which adopts standards for securities markets; and
- The IASB,[283] which adopts International Financial Reporting Standards (IFRS).

211. Wim Mijs praised the work of such bodies.[284] Yet Benoit Lallemand was concerned that the momentum behind ensuring international consistency was slowing down. He anticipated that the FSB could lose influence as local regulators gained power. He saw the FSB's level of credibility, authority and autonomy as relatively weak. He called for the FSB's powers and resources to be strengthened to ensure more international coherence.[285]

212. Sir Jon Cunliffe and Andrea Enria explained that reviews of national implementation by the Basel Committee highlighted international inconsistencies, going so far as to name and shame jurisdictions, with the objective of helping them to align with international standards.[286]

213. Witnesses described the changing dynamics of the relationship between the EU and international bodies. Kern Alexander said that the Basel Committee had traditionally been dominated by individual Member States. Lucia Quaglia stressed that the EU did not speak with one voice at the level of the Basel Committee, as individual Member State preferences when transposing Basel III into European legislation demonstrated. Yet they both predicted that the ESAs, the ECB and other EU institutions would play a greater role in the level of input to international standard-setting bodies.[287]

### Recommendations and conclusions

214. **We welcome the efforts of EU leaders to assert the EU's influence in the international standard-setting agenda. We note in particular the continuing efforts to maintain a regulatory dialogue with the US. We reiterate our view that the EU is right to press the US to include financial services regulatory matters in TTIP.**

215. **It is difficult to draw a distinction between G20 inspired measures and EU-specific reforms, and therefore to ascertain the extent to which the EU has been guilty of 'gold-plating'. This is particularly so given the influence of the EU and its Member States in the global standard-**

[283] International Accounting Standards Board.

[284] Q 93

[285] Q 94

[286] Q 178 (Andrea Enria) and Q 263 (Sir Jon Cunliffe)

[287] Q 39

**setting bodies and the breadth of the G20 agenda. On balance, however, we conclude that the EU has been at its most effective when implementing core elements of the G20 agenda and that regulatory design problems have been most apparent with respect to those measures whose connection to the G20 agenda is less apparent. Chief among these measures are AIFMD and the FTT proposal.**

216. **The EU has also shown a tendency to interpret international standards according to the characteristics of the EU financial sector. We acknowledge that a completely level international playing field is unrealistic, at least in the immediate future, because of the different characteristics of global markets. Adjustments to take account of EU circumstances are understandable and sometimes justified. We also acknowledge that differences in implementation by EU Member States can make it more difficult to achieve a level international playing field. Yet it is in the long-term interests of the global financial system for key players, whether in the EU and the US, and increasingly in Asia and other developing markets, to work together to ensure that regulatory consistency is maintained.**

217. **International fora such as the G20, the FSB and IOSCO have a crucial role to play in this process. They must be supported by the EU and its global partners, whether in terms of time, commitment and resources, if they are to prove effective. More specifically, greater co-ordination is needed at the international level to identify and lay out an effective process for ensuring international consistency in relation to the treatment of derivatives.**

# CHAPTER 6: THE IMPLICATIONS FOR THE UK

## Introduction

> "The UK is the largest net exporter of financial services and insurance in the world. In December 2013, UK financial services and insurance accounted for more than 1.1 million jobs, two-thirds of which are outside London … 80% of hedge fund management and 70% of private equity management in the EU takes place out of the UK. Moreover, three-quarters of European capital markets and investment banking revenue are transacted in this country. The UK has the fourth largest banking sector globally and accounts for 41% of global foreign exchange … this industry is vital to the UK and … it is more vital to the UK than it is to any other EU Member State."[288] (Andrea Leadsom MP, Economic Secretary to the Treasury)

218. This chapter considers the implications of the new financial sector regulatory framework for the UK under a number of themes:

- The impact of the Single Market on the UK;
- The impact of eurozone integration on the UK and other non-eurozone Member States, and the threat of eurozone 'caucusing';
- Whether the core elements of the EU financial regulatory framework would have been implemented in the UK had it acted unilaterally;
- Whether UK influence in shaping the financial services regulatory framework is waning;
- Whether the UK Government and other UK authorities have been effectively engaged with the EU institutions;
- The importance of the City of London as the global financial centre for the EU.

## The UK and the Single Market

219. The benefits of the Single Market to the UK economy were acknowledged by several witnesses. While Standard Life conceded that it was a work in progress, they argued that the Single Market provided all Member States with access to markets that would otherwise be surrounded by tariff barriers, and acted as a portal to third countries who wanted access to EU markets. They said that financial services in the UK gained significant benefits from the Single Market, and that the competitiveness of financial services in the UK depended, to a degree, on being part of the European financial services regulatory framework.[289] The Minister agreed that "the EU Single Market remains a key asset for financial services right across the UK, with firms

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[288] Q 280. In addition we note the importance of the insurance sector to the UK economy. The UK insurance industry (which manages assets amounting to £1.8 trillion) is the largest in Europe and the third largest globally and accounts for some 314,000 jobs in the UK. See Association of British Insurers, *UK insurance key facts* (2014): https://www.abi.org.uk/~/media/Files/Documents/Publications/Public/2014Key%20Facts/ABI%20Key%20Facts%202014.pdf [accessed 9 January 2015]

[289] Written evidence from Standard Life (FRF0024)

establishing themselves in the UK stating that access to the EU Single Market is a key reason for doing so."[290]

220. On the other hand, the Building Societies Association cautioned that the benefits of the Single Market in financial services were not always evenly distributed, with some participants being subject to the regulatory burdens of Single Market access but not being in a position to benefit from the Single Market. They gave a number of examples of disadvantages affecting the UK market, including the displacement of the UK mortgage application 'Key Facts Illustration' and the imposition of harmonised regulatory reporting under CRD IV. This imposed a "colossal burden" and substantial costs on building societies (of between £189 million and £278 million), to no apparent benefit.[291] As we have seen, the Wealth Management Association said that EU-wide regulations did not work for retail markets which were "national and constrained by local culture and tax laws."[292]

221. **The Single Market has its imperfections and remains incomplete. Its benefits are also felt more keenly in the wholesale markets than in retail markets, where the benefits of cross-border services are less apparent. Nevertheless the Single Market remains a fundamental driver of growth across the EU and is thus of demonstrable benefit to the UK economy. Given the UK's leading position, the development of the Single Market in financial services is a key determinant of the continued prosperity of the UK financial services sector.**

### Eurozone caucusing?

222. A number of our witnesses warned that greater eurozone integration posed a threat to the integrity of the Single Market (and in particular the single rulebook), and by implication to the influence and interests of non-eurozone Member States such as the UK. Much of this concern revolved around the Lisbon Treaty change to the voting rules for a qualified majority in Council as from 1 November 2014, so that "a qualified majority shall be defined as at least 55 per cent of the members of the Council, comprising at least fifteen of them and representing Member States comprising at least 65 per cent of the population of the Union."[293] As a result of this change, eurozone countries now have a qualified majority in the Council.[294] This, together with the establishment of Banking Union,[295] raised the spectre of eurozone 'caucusing'.

223. Graham Bishop argued that the threat of such caucusing had grown. He cited the UK Government's legal challenge on the location of central counterparties, where "it would be extraordinary if the ECB's strong view about the prudent need for control over CCPs were not given full support by

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290 Q 271

291 Written evidence from the Building Societies Association (FRF0004)

292 Written evidence from the Wealth Management Association (FRF0014)

293 TFEU Article 16. On this point, see written evidence from Graham Bishop (FRF0006).

294 Written evidence from the British Bankers' Association (FRF0015). See also Open Europe, 'Lisbon Treaty's new voting weights kick in—Eurozone gains a majority' (3 November 2014): http://openeuropeblog.blogspot.co.uk/2014/11/lisbon-treatys-new-voting-weights-kick.html [accessed 9 January 2015]

295 See paras 228–31.

all euro area states”. In his view, “the cost for the UK of not having joined the euro may now be creeping over the horizon.”[296]

224. The BBA said that while there were numerous divisions between eurozone Member States, the risks of caucusing had increased. The BBA cited the FTT as a case where the interests of non-participants were not respected.[297] Douglas Flint noted that the double majority mechanism in the EBA was very important. Under this mechanism, key decisions, including on standards applying across the Single Market, need to be approved by a simple majority of members of the EBA Board of Supervisors of both Banking Union participating and non-participating Member States. However, there would be a review of voting arrangements if and when the number of non-participants fell to four. Thus Mr Flint said that there was a question as to whether the mechanism would remain sustainable as the number of ‘outs’ fell.[298]

225. The City of London Office in Brussels also saw dangers in a two-speed Europe. Yet there were safeguards, including the double majority voting rules in the EBA and the strength of the bilateral relationship between the ECB and the Bank of England. They also pointed out that the eurozone had its own fears because a large chunk of its wholesale markets were in London. The key was to “have a structure that reassures everyone”.[299] The City of London Office in Brussels were amongst several witnesses who argued that caucusing was a latent threat rather than a real and present danger. Other than on bank bonuses, efforts were typically made to get the UK ‘on board’.[300]

226. Several other witnesses thought that the danger of UK marginalisation was overblown. Sharon Bowles criticised as facile the presumption that there would be a straight division between euro ins and outs. Nevertheless, she argued that ensuring that the Eurogroup met after the ECOFIN Council rather than before, would help guard against issues coming before ECOFIN as a *fait accompli*.[301]

227. The Minister conceded that there was a significant risk that eurozone countries would start to caucus, and that the EBA double majority rule might not last forever. It was inevitable that eurozone countries would need to make decisions to support the eurozone, and the UK needed to be alert that its interests were not damaged.[302]

228. Of all the elements of the financial sector regulatory framework, Banking Union has perhaps the greatest potential to create divisions between eurozone and non-eurozone Member States. Banking Union is mandatory for eurozone Member States but other Member States may join on a voluntary basis.

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296 Written evidence from Graham Bishop (FRF0006)

297 Written evidence from the British Bankers’ Association (FRF0015)

298 Q 210

299 Q 138 (Mike Vercnocke)

300 Q 139 (Elizabeth Gillam). See also Q 198 (Anthony Browne) and written evidence from the International Regulatory Strategy Group (FRF0017).

301 Q 21

302 QQ 286–87

229. Douglas Flint foresaw the ECB growing in influence thanks to its increased powers under Banking Union. While he stressed that the Bank of England, the US Federal Reserve and the ECB were likely to agree on many issues, the UK needed to maintain a constructive relationship with the ECB so as to maximise its influence.[303] Andrew Bailey also stressed the critical importance of the strong relationship with the ECB, and said that existing relationships between the ECB and the Bank of England were good.[304]

230. Andrea Enria said that to some extent Banking Union was a contribution to restoring the integrity of the Single Market more generally, but he acknowledged that it created the potential for polarisation between ins and outs.[305] He thought that the UK had taken a "very defensive" attitude to Banking Union, focusing on concern about the ECB's growing power and the need to ensure that the UK was able to block rules it disagreed with. He stressed that there should be a common focus on strengthening and repairing the Single Market rather than on searching for potential tensions.[306]

231. **The steps towards further eurozone integration, encapsulated in Banking Union, are an essential precondition for the restoration of growth and prosperity both in the single currency area and across the EU as a whole. It is therefore in the UK's interests that a meaningful process of closer integration continues.**

232. **Such integration has unavoidable consequences for the UK. There is little sign of eurozone caucusing taking place as yet, but it is certain that the eurozone will have to integrate even further if the future of the single currency is to be secured. Safeguards must be put in place to secure the integrity of the Single Market as well as the rights and interests of non-eurozone Member States.**

233. **In that regard, we welcome the UK Government's successful campaign to reform the voting rules in the EBA. Yet such safeguards may not last forever, and voting weights in the Council have changed, giving the eurozone a qualified majority. Further protection is therefore needed. The new Commission must renew its commitment to the protection of the Single Market. The powers, authority and resources of the European Supervisory Authorities must be strengthened given their pivotal roles in supporting the single rulebook. We also recommend that the Eurogroup should meet after the ECOFIN Council rather than before, to reduce the risk of issues coming before the Council as a *fait accompli*.**

234. **The UK authorities can also do more to take account of the growing influence of eurozone bodies such as the ECB and the Eurogroup. We welcome the fact that strong working relationships exist between the Bank of England and the ECB. Effective structures of co-ordination must be maintained in order to ensure that the UK's influence in the design of regulatory and supervisory structures is maintained.**

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[303] Q 214

[304] Q 266

[305] Q 183

[306] Q 185

## The UK and the EU: a consistent regulatory approach?

235. We asked our witnesses whether the main elements of the EU financial sector regulatory framework would have been enacted in the UK irrespective of its membership of the EU.

236. Sharon Bowles described as "rubbish" the "all-pervading notion that in the absence of EU regulation there would be no regulation" in the UK. In her view, a UK-only regulatory framework would have been more stringent, as the UK Government's push for tighter regulation over the CRD IV/CRR negotiations demonstrated.[307] She said that the UK had "blindly followed" the Basel agenda and had been guided by the philosophy that: "If it moves, slap on capital; even if it does not move, slap on capital. Require more liquidity. Ring-fence it. Tie it down."[308] She also pointed out that the UK had often led discussions at international level, for instance with regard to bank recovery and resolution.[309]

237. The Minister stressed that the UK had played a significant leadership role in the development of international standards. Consequently many of the reforms would have been enacted even if the UK had not been in the EU.[310] Simon Gleeson said that, of the 40-plus pieces of legislation, with one or two exceptions: "Had Europe not existed, every single one of those directives would have been implemented here for exactly the same reasons that they were implemented at the European level, because they were part of a globally considered response to the crisis."[311] He pointed out that at FSB/G20 level most of the policy input came either from the UK or the US, so "we are making policy for ourselves through a very long and devious route."[312]

238. Kern Alexander noted that the UK was an important participant in FSB discussions on international standard-setting, and in the Basel III discussions on capital requirements.[313] In terms of EU legislation, the UK had spearheaded both the BRRD and the deposit guarantee scheme revisions.[314] Douglas Flint argued that, with the exception of bank remuneration arrangements, it was very difficult to point to EU reforms that had been particularly problematic in the UK context.[315]

### *UK gold-plating?*

239. The City of London Office in Brussels argued that gold-plating was sometimes justified in the UK context because EU legislation would be insufficiently developed for the highly developed markets in London. By contrast, some other Member States could simply cut and paste the text of a directive.[316]

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[307] Q 5

[308] QQ 5–6

[309] Q 2

[310] Q 271

[311] Q 46

[312] Q 56

[313] Q 43

[314] Q 44

[315] Q 209

[316] Q 119 (Mike Vercnocke)

240. Douglas Flint said that the main examples of UK gold-plating were designed to accelerate the adoption of rules that would be enacted across the globe at some point. He stressed the responsibility of regulators to reflect the specific circumstances of a market. He therefore supported minimum standards and national regulators giving effect to more specific concerns. He did not think that this was a problem so long as there was a well-argued case for differentiation. However, different rules became more problematic in the context of cross-border wholesale markets.[317]

241. **We acknowledge that elements of the financial sector regulatory framework have proved particularly problematic for the UK. The bank remuneration provisions in CRD IV, AIFMD and the longstanding arguments about the Financial Transaction Tax are three cases in point. There are also less prominent examples, not least in relation to the retail market.**

242. **Yet with these exceptions, it is likely that the UK would have implemented the vast bulk of the financial sector regulatory framework had it acted unilaterally, not least because it was closely engaged in the development of the international standards from which much EU legislation derives.**

243. **We acknowledge that UK regulation goes further than the EU baseline in a number of prominent cases. The arguments for and against gold-plating are finely balanced. On the one hand, the specific features of a financial market as developed as that in the UK need to be taken into account. On the other, the more regulatory inconsistency that is created, the greater the threat of regulatory arbitrage and of competitiveness risks. Such inconsistencies also stand as impediments to the smooth functioning and development of the Single Market in financial services. On balance, we find that while it may sometimes be necessary to take account of the distinctive features of the UK markets, the assumption must remain that the advantages of consistency across the Single Market should prevail unless there is a clear and demonstrable case why this should not be so.**

## Maximising the UK's influence

244. Several of our witnesses expressed confidence that the UK maintained a strong influence over EU financial services regulation. Sharon Bowles asserted that the knowledge and experience of the UK regulators was very powerful, and this was acknowledged in Brussels.[318] David Lawton said that the UK continued to be respected in EU dialogue because of its technical expertise. He had no sense of a loss of influence.[319]

245. The City of London Office in Brussels agreed that the UK was seen as expert in the field. However, they detected a sense that the debate about UK membership of the EU was having an impact on the way the UK was viewed in Brussels. There was a perception that the UK was arguing that "if regulation comes from Brussels it is bad, if it comes from Westminster, it is

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317 Q 213

318 Q 20

319 Q 231

good". They stressed that "the idea that everyone has got it in for the City of London or for the UK is slightly misguided." Antipathy was directed against the financial industry as a whole rather than London, and the City bore the brunt of such criticism simply because the majority of the wholesale market was in London.[320] There was also a "constant need to justify ourselves" because of controversies like LIBOR.[321]

246. The Minister argued that:

> "A good principle to follow would be that a principal industry in one Member State should not be undermined by others … This is a hand-to-hand issue where we need to negotiate very hard on behalf of the UK's interests on a case-by-case basis. At times we have to put up a challenge in the courts, as we have done in the past, but at other times we just have to argue very loudly".[322]

*The role of the UK Government*

247. One significant determinant of the strength of the UK's influence is the nature of the UK Government's (and other UK authorities') engagement with Brussels.

248. Our witnesses painted a mixed picture. Sharon Bowles said that the UK had made a positive technical contribution to proposals such as those relating to Banking Union.[323] Yet its approach to negotiations amounted to "regulatory selfishness … If we can do it ourselves, please still let us do it ourselves".[324] She cited the UK's "schizophrenic and immature" approach to the role of the ESAs:

> "On the one hand you want the PRA and the FCA to be in there doing their stuff in ESAs, but actually you would much rather that they were able to do it all by themselves. You like the discipline when it applies to somebody else, but not when it comes back to discipline the UK."[325]

249. Sharon Bowles also criticised the way in which the UK presented itself in negotiations, for instance in sending the Deputy Governor of the Bank of England to informal ECOFIN and Governors' meetings, rather than the Governor.[326]

250. The BBA said that they had been encouraged by the engagement of UK authorities in recent EU negotiations, and the UK's willingness to challenge inappropriate rules. Nevertheless, there was an overwhelming case for the UK to devote more resource and expertise to engaging in the EU process.[327]

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320 Q 118 (Elizabeth Gillam and Mike Vercnocke)

321 Q 121 (Mike Vercnocke)

322 Q 280

323 Q 22

324 Q 24

325 Q 12

326 Q 21

327 Written evidence from the British Bankers' Association (FRF0015)

Nicolas Véron argued against any isolation of the UK from the EU policy process "because we lose an important force to push for better regulation."[328]

251. Karel Lannoo argued that countries such as Germany were more visible in their lobbying than the UK.[329] The BVCA suggested that the UK could learn from the approach of other Member States in maximising influence in relation to industries of national importance.[330] The IRSG stated that while the EBA double majority rules had been an example of a good outcome for the UK, "the UK Government could achieve such outcomes more frequently if it were better engaged in the European debate and able to build a coalition of support with like-minded countries."[331]

252. Simon Gleeson's judgement was scathing:

> "There was an extraordinary UK disengagement at the policy level at a sufficiently early stage. It is my personal opinion that certain UK Government departments, particularly the Treasury, proceeded for far too long under the illusion that they were sovereign law-makers when in fact they were not. Over the last seven years, we have seen a rather violent correction of that illusion. In order to correct that, it is necessary for those who make financial policy in the UK to be clearly aware that financial policy is no longer made in Horse Guards Parade—it is made in Brussels—and to manage the making of policy on that basis."[332]

253. The Minister pointed to the work that the UK Government had undertaken to reject the proposed bonus cap on UCITS fund managers, in securing flexibility for the UK to implement its own macroprudential regime within the scope of CRD IV, in securing capital relief for British insurers holding assets against long-term liabilities through Solvency II, and in exempting British pensions from new rules on disclosure of investment products. She also cited cases where the Government believed that EU legislation was at odds with the treaties and had initiated action at the Court of Justice of the European Union, including with respect to the FTT, the location of clearing houses and the bank remuneration provisions in CRD IV.[333] Her conclusion was that the UK was not on the sidelines, but was "very much plugged in".[334]

### *Engagement with the European Parliament*

254. Specific concerns were raised about declining UK influence in the European Parliament. Graham Bishop said that the UK's performance in the last European Parliament term was "outstanding", led by the ECON Chair Sharon Bowles. By contrast, its influence over the new European Parliament had "gone down with a bump". He was concerned that UK rapporteurs were unlikely to be given any major City-sensitive dossiers.[335]

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328 Q 61

329 Q 79

330 Written evidence from the British Private Equity and Venture Capital Association (FRF0010)

331 Written evidence from the International Regulatory Strategy Group (FRF0017)

332 Q 60

333 Q 271

334 Q 277

335 Written evidence from Graham Bishop (FRF0006)

255. The Wealth Management Association asserted that there appeared to be little co-ordination between MEPs and Westminster MPs. They argued that improved co-ordination could help strengthen the quality of parliamentary debate on EU matters in Westminster and Brussels.[336] HM Treasury pointed to successful engagement with MEPs on the MiFID II and EMIR proposals, although it conceded that there was a need to re-establish relationships with the new European Parliament and Commission.[337]

### *UK officials in the Brussels institutions*

256. A number of witnesses expressed concern about the low numbers of UK officials in key posts in the EU institutions. The BBA called for a significant increase in the number of UK officials appointed to the EU institutions.[338] Its July 2014 report on *British influence in the EU* concluded that the UK was "facing a cliff edge in terms of the number of senior officials it has in the Commission. Many of the highest ranking British officials are near retirement age and there is no pipeline of junior colleagues ready to replace them."[339] Standard Life argued for an increase in FCA and PRA secondments to EU institutions, supervisory bodies and other international regulators. They also called on the UK to ensure that more UK nationals were working at the Commission.[340]

257. On the other hand, Verena Ross noted that there were 12 British nationals on a contract with ESMA (so-called 'Temporary Agents') as well as five British nationals seconded to ESMA by the FCA as Seconded National Experts, which was "reasonably proportional to the other big countries."[341] David Lawton told us that the FCA was active in the ESAs providing technical advice and commentary on legislation.[342]

258. The Minister said that HM Treasury, the FCA, PRA and the Bank of England had 14 officials seconded to the Commission, three at the EBA, six at ESMA, one at EIOPA, two in the ECB and one at the ESRB—27 officials in total. In addition, 74 FCA officials participated in the ESA Committees.[343]

259. It is also important in this context to welcome the appointment of Lord Hill of Oareford as Commissioner for Financial Stability, Financial Services and Capital Markets Union. The Minister acknowledged that he would be speaking for the Commission as a whole, but was nevertheless confident that he would understand the significance of the financial sector for the UK.[344]

260. **It is fundamentally important that the Government must ensure that the UK is not perceived by EU colleagues to be pursuing an obstructionist or purely self-interested agenda. The Government needs to demonstrate by its actions and its words that it has the best**

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336 Written evidence from the Wealth Management Association (FRF0014)

337 Q 278 (Katharine Braddick, Director of Financial Services, HM Treasury)

338 Written evidence from the British Bankers' Association (FRF0015)

339 British Bankers' Association, *British influence in the EU* (July 2014): https://www.bba.org.uk/publication/bba-reports/british-influence-in-the-eu-2/ [accessed 9 January 2015]

340 Written evidence from Standard Life (FRF0024)

341 Q 246

342 Q 236

343 Q 277

344 Q 289

**interests of the Single Market and the EU as a whole at heart, and not just the UK's own narrow interests.**

261. **It is gratifying to hear that the UK's expertise in relation to financial services is still respected. Yet it is our belief that the UK's influence over the legislative process continues to diminish. We identify several possible causes:**

- **The impact of the ongoing debate about the UK's place in the European Union on opinions about the UK;**
- **A perception of growing UK antipathy to 'Brussels regulation';**
- **The indirect effect of hostility towards the financial services industry in light of that sector's prominence in the UK economy;**
- **An occasionally unhelpful tone and attitude on the part of UK authorities when dealing with EU counterparts;**
- **Insufficient commitment to the hard graft of effective lobbying, negotiation and alliance-building;**
- **A declining influence in the European Parliament, in spite of the hard work of those UK MEPs who remain constructively engaged;**
- **A paucity of senior UK officials in EU institutions.**

262. **The UK Government must act urgently to increase the UK's influence over the future development of the financial sector regulatory framework. One practical step would be to place greater emphasis on the value of a career in the Brussels institutions for UK officials. A second would be to ensure that the UK seeks to influence the policy debate at the earliest opportunity. A third would be to enhance contact between UK authorities and MEPs not only from the UK but from all Member States. Given the importance of the financial sector to the UK economy, the Government would be failing in its duty to protect the interests of the UK if it did not do everything possible to enhance its influence among the EU institutions.**

263. **In addition, all UK MEPs need to play a full and active part in the work of the Parliament and its Committees if the UK's influence within the European Parliament is to be enhanced. To that end, we also acknowledge this Committee's own responsibility to ensure that good relations between national parliaments and the European Parliament are maintained.**

### The City of London: the EU's global financial centre

264. Two further interlinked themes emerged from our evidence. On the one hand, witnesses stressed that, in order to continue to function as the EU's global financial centre, the City of London needed to be subject to EU rules. Simon Gleeson argued that:

> "If London … wants to be the European financial centre, Europe must feel that it is able to regulate it effectively … It is not simply a matter of saying who is technically the best regulator; you are saying, 'Who needs

> to feel that they have a hand in the regulation of this thing?' … We still do not have sufficient European control of the City of London to leave other European governments happy with the fact that increasingly Europe has only one financial centre".[345]

265. Sharon Bowles agreed:

> "Just because the fund management is in London, that does not mean that London can have *carte blanche* to regulate. An awful lot of bad things have happened in London. The London Whale[346] was in London. Benchmark fixing was in London. FX fixing was in London. When these things continue to come out—and are happening under our noses—you cannot stand up to the rest of Europe and say, 'We should make the regulation because it is all with us. The fact that it has gone wrong is nothing to do with us—and, by the way, we want to export it all to you, because we are the largest exporter of financial services'."[347]

266. On the other hand, there is an imperative on all EU authorities to acknowledge that the UK financial services industry centred on the City of London is beneficial not just for the UK but for the whole of the EU. The Minister stressed that "the financial services serve Europe":

> "Before the financial crisis, financial services—largely based in the UK—benefited each of the European economies by about 1% of GDP per year. So everyone is benefiting from something where the UK has a particular expertise [and] … it is in the interests of all of the EU to defend this very important industry."[348]

267. **We acknowledge that the EU must have confidence in its ability to regulate the City of London effectively if it is to retain its faith in and commitment to the City's continuing function as the global financial centre for the EU. The prosperity of the City of London, and the financial services industry that it hosts, is in the interests not only of the UK but of the EU as a whole.**

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345 Q 58

346 The 'London Whale' scandal relates to the large trading losses sustained by JP Morgan following transactions in credit default swaps by a London-based trader (the 'London Whale') in 2012. The losses amounted to some $6 billion and a series of fines were imposed on JP Morgan by the US and UK authorities in respect of failures relating to risk management.

347 Q 7

348 Q 289

# CHAPTER 7: THE FUTURE

## Introduction

268. The reforms to the financial sector regulatory framework are unprecedented in EU history, in their scale and ramifications. They also carry significant implications for the future priorities of the new Commissioner for Financial Stability, Financial Services and Capital Markets Union, Lord Hill of Oareford. This chapter focuses on the key questions that the new financial sector regulatory framework gives rise to for the future. These include:

- Should there be a period of calm before further reforms are brought forward, or are further reforms necessary before the regulatory framework can be considered to be complete?
- What needs to be done in relation to existing legislative proposals such as those relating to shadow banking and bank structural reform?
- What steps should be taken to promote the growth agenda in light of the significant economic challenges facing the EU?
- What is the Commission seeking to achieve through its proposals for 'An Investment Plan for Europe' and Capital Markets Union?

## A period of calm?

269. Michel Barnier acknowledged that his programme of legislative measures was not the end of the road. He said that the next Commission would have to focus on implementation and on enforcement, where necessary, of the reforms. The review clauses would give an opportunity to evaluate and perhaps to improve the texts. He said that financial markets changed quickly, and "we need to make sure that our rules evolve as well."[349] As we have seen, there are also over 400 pieces of Level 2 regulation to be adopted in the coming years.[350]

270. Several witnesses stressed the need for a period of calm before countenancing further legislative reforms. AFME argued that this was necessary because "the pace of change in EU financial services legislation is neither sustainable nor desirable if Europe is to fully reap the economic benefits of transformation that has already taken place."[351] Anthony Browne called for "a period of stability on the regulatory front to see exactly what the impact of all this is and whether any future reforms are necessary."[352]

271. Douglas Flint said that the EU needed to give the industry confidence that regulatory reform had an end point.[353] As we have seen, Colin Tyler stressed the disincentive to business investment created by uncertainty about future regulatory reform.[354] David Lawton stated that the key over the next two to

[349] Q 101

[350] See para 48.

[351] Written evidence from the Association for Financial Markets in Europe (FRF0012)

[352] Q 194

[353] Q 208

[354] Q 224

three years was a smooth and proportionate implementation of the various legislative dossiers. In his view, there was no need for a new legislative agenda—quite the opposite.[355]

272. Nonetheless, the IRSG stressed the importance of seizing the opportunities presented by review clauses to assess the effectiveness of new legislation and to amend it as necessary. In addition, while a hiatus from further reform would be welcome, they argued that there were still gaps in the regulatory framework, including proposals on recovery and resolution for financial market infrastructure, which needed to be filled before the reform project could be said to be complete.[356]

273. Others suggested that a full review of the new framework would have to wait. Colin Tyler thought it would take a decade to assess the full impact of the new framework and how it fitted together.[357] Sharon Bowles argued that it was better to leave dossiers such as AIFMD alone than to open them up and risk making things worse.[358] On the other hand, Sir Jon Cunliffe said that the financial sector evolved so fast and was so complex that problems needed to be dealt with as they arose.[359]

274. The Minister, Andrea Leadsom MP, favoured a period of calm, because undoing a bad piece of legislation was more painful and expensive than living with it. On the other hand, she recognised the natural urge to address a problem once it was identified.[360]

275. Notwithstanding the calls for a period of calm, substantial progress needs to be made in fulfilling the four fundamental principles of the EU. We note in particular that the principle of the free movement of services has not been developed at the same pace as the other three freedoms.

276. **The pace and scale of legislative reforms over recent years were unprecedented. We sympathise with the pleas of the financial services industry for a period of calm and with its desire for a definitive end point to the process of reform. We agree that the legislative programme needs to slow down in order to enable industry to get to grips with the changes that have been made and to ensure effective implementation of the reforms that have already been agreed.**

277. **Yet the vision of a fixed and completed regulatory framework is likely to prove a mirage. The financial sector is constantly evolving, and financial sector regulation will need to keep up. It is both unwise and unrealistic to set an artificial end point to the reform process.**

278. **At the same time, the Commission should bring forward legislation only where the case for action has been effectively made. We have already criticised the Commission for a tendency to judge its effectiveness by its legislative output. We accordingly call on the new**

355 Q 239

356 Written evidence from the International Regulatory Strategy Group (FRF0017)

357 Q 219

358 Q 8

359 Q 257

360 Q 273

**Commission to resist any urge to legislate without clear evidence of necessity. Increased regulatory stability is now highly desirable.**

## Gaps in the regulatory framework

279. We also sought views as to whether any further legislative reforms were needed. Michel Barnier pointed to the outstanding legislation to be pursued by the new Commission, including measures on bank structural reform, benchmarks, shadow banking (including Money Market Funds), money laundering and payment services.[361]

280. Some witnesses commented on the new risk environment created by the G20 reforms to the OTC derivatives market (implemented through EMIR in the EU) and, in particular, on the requirement for certain derivatives to be cleared through CCPs. The CCP clearing requirement is designed to reduce the risks associated with bilateral clearing. But notwithstanding the new regulatory regime supporting CCPs, concern was expressed as to the resulting concentration of risk within CCPs. Given the systemic risks posed by CCP failure, support was expressed for appropriate recovery and resolution procedures for CCPs as well as for critical financial market infrastructures generally, such as Central Securities Depositories (CSDs). The EU has already legislated to address recovery and resolution of banks and certain investment firms (the BRRD), but has yet to present proposals with respect to financial market infrastructures.

281. In this context, Elizabeth Gillam, Deputy Head of Office, City of London Office in Brussels, stressed the importance of guarding against future risks. Given that risk was now being concentrated in CCPs, she would support legislation addressing the recovery and resolution of CCPs and CSDs.[362] The IRSG agreed that the move towards central clearing had led to a concentration of risk in CCPs. They supported the introduction of recovery and resolution legislation for financial market infrastructures.[363]

282. With regard to the derivatives markets reforms, the BBA stated that challenges in existing legislation could be identified, including difficulties with reporting standards in relation to OTC derivatives, the unresolved question of third country CCP equivalence and divergences in regulatory standards between the EU and US inhibiting cross-border derivatives trading and capital flows.[364]

283. Aside from these points, our witnesses focused in particular on two outstanding issues, the proposals for shadow banking and bank structural reform.

### *Shadow banking*

284. Box 5 outlines the shadow banking reform agenda.

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[361] Q 103

[362] Q 126

[363] Written evidence from the International Regulatory Strategy Group (FRF0017)

[364] Written evidence from the British Bankers' Association (FRF0015)

**Box 5: The shadow banking sector**

The shadow banking reform agenda is designed to capture the risks associated with maturity and liquidity transformation. Broadly, it is concerned with addressing the risks associated with credit intermediation by market participants and through activities which are outside the regular banking sector. In particular, maturity and liquidity transformation is a central function of the banking sector: a bank takes on liquid deposits as bank liabilities (through short term borrowing from depositors), but lends over the long term in the form of less liquid loans (bank assets).

Banking regulation has evolved to address this short-term liability and long-term asset mismatch risk. But the crisis revealed that an array of institutions and practices were achieving maturity and liquidity transformation effects outside the banking regulation perimeter. While they were providing an important alternative funding source, they were also generating significant systemic risks. In particular, the importance of securitisation and of securities repurchase ('repo') and lending agreements used by market participants became clear. The potential risks of Money Market Funds did likewise. The scale of the shadow banking sector, estimated at some €53 trillion globally, at half the size of the regulated banking sector, has also become clearer.[365] As banking regulation has become more intense in the wake of the crisis, and in particular given the potential impact of structural reforms on the regulated banking sector, the reform agenda has come to reflect concern that activities may be driven from the regulated banking sector to the unregulated, or 'shadow' banking sector.

The international reform agenda is being spearheaded by the FSB. In the EU, a number of reforms can be associated with the shadow banking agenda, including the CRD IV/CRR and Solvency II reforms and the rating agency regime. Yet it is in particular associated with the Money Market Funds Proposal and the Transparency of Securities Financing Transactions Proposal, both currently under negotiation. Further reforms are expected to follow with regard to, for example, collection and exchange of data, the Legal Entity Identifier agenda, and the strengthening of the UCITS regime with respect to securities financing transactions in particular.

285. Sir Jon Cunliffe said that shadow banking was the main area where further regulation was needed.[366] The key issue was that:

> "We know a lot about the banking sector, we know a lot about the insurance sector and they are quite regulated. We do not know that much about the universe of asset managers, different funds, different investment funds, who all have different strategies and … mutate very quickly in that environment."[367]

286. Kern Alexander agreed that enhanced scrutiny of the sector was needed.[368] The IRSG stated that the increase in shadow banking activities may pose

365 Proposal for a regulation of the European Parliament and of the Council on reporting and transparency of securities financing transactions, COM(2014) 40 FINAL. The figure cited refers to 2012.

366 Q 253

367 Q 260

368 Q 27

new risks which would need to be monitored.[369] Yet Karel Lannoo was not convinced that shadow banking was a big issue because many of its elements had already been regulated.[370]

287. **We acknowledge that the shadow banking sector plays a pivotal role in the smooth operation of the economy, and in particular as a much-needed alternative financial driver to the regulated banking sector. Regulation intended to contain the risks of shadow banking must not prejudice its benefits to the wider economy and, in particular, its ability to support capital-market-based funding. Over-regulation will only drive risk into further unregulated areas. Reform must make shadow banking safer but not suppress it.**

288. **The case for monitoring and regulation of the shadow banking sector is a strong one, in particular to take account of the shift in risk from the regulated sector into the unregulated sector, and the incentives which the enhanced regulation of banks has created for activities to move outside the regulated sector. Little is known about the intricacies of the shadow banking sector compared to the regulated banking sector. Enhanced transparency and understanding of the sector is therefore vital if systemic risks are to be identified and dealt with.**

*Bank structural reform*

289. The Commission's proposals for bank structural reform were published in February 2014.[371] They were brought forward in response to the report of the High Level Expert Group on reforming the structure of the EU banking sector, chaired by the Governor of the Bank of Finland, Erkki Liikanen. The Commission proposed a ban on proprietary trading by certain categories of financial institution, and a requirement for competent authorities to review credit institutions and to determine whether to require them to separate their deposit-taking activities from their trading activities. The proposal also included provisions to allow credit institutions subject to national primary legislation at least equivalent to the EU proposal to derogate from the structural separation requirement. This so-called derogation clause would permit the UK to implement the Vickers reforms in full.[372] The legislative proposal has proved contentious during negotiations thus far, not least because a number of Member States, including France and Germany, have taken forward structural reforms at national level. Agreement is not expected before the end of 2015 at the earliest.

290. Witnesses from the financial sector roundly criticised the Commission's proposals. AFME described them as "an unnecessary duplication of existing measures and, if adopted, will have significant adverse economic consequences, including a withdrawal of EU capital market capacity." AFME argued that the proposals would interfere with the provision of client-

369 Written evidence from the International Regulatory Strategy Group (FRF0017)

370 Q 68

371 Proposal for a regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions, COM(2014) 43 FINAL

372 See Government Explanatory Memorandum on the proposal: http://europeanmemoranda.cabinetoffice.gov.uk/files/2014/03/6022–141.pdf [accessed 9 January 2015]

facing activities such as market making and risk transformation services that were part of banks' fundamental economic role.[373]

291. The IRSG pointed out that national measures had already been taken, and trying to harmonise this area at such a late stage would only lead to uncertainty and additional cost.[374] Anthony Browne agreed that "you would not design a process with lots of individual, national bits of legislation followed by sort of pan-European bits of legislation, where it is not entirely clear how all that would fit together."[375]

292. Wim Mijs criticised the bank structural reform proposals as a politically motivated afterthought.[376] Professor Rosa M Lastra, Professor of International Financial and Monetary Law, Queen Mary University of London, bemoaned the way in which the Volcker rule, the Vickers reforms, the Liikanen report and the Barnier legislative proposals all pointed in different directions.[377]

293. Only Benoit Lallemand defended the proposal, calling on the UK to be a strong advocate of the proposal so as to ensure as much of a level playing field across the EU as possible.[378]

294. **The Commission's proposals for bank structural reform are highly contentious, particularly given that Member States including the UK, Germany and France have already brought forward structural measures at national level. This illustrates many of the failures in the legislative process that we have highlighted, including a counter-intuitive scheduling of legislative reforms. The optimal moment for bank structural reform had passed by the time the proposal was brought forward in the dying days of the old European Parliament and Commission.**

295. **Nevertheless, we are concerned that the financial sector is overstating its objections in an effort to encourage the Commission to drop the proposals. The lack of consistency between the Volcker, Vickers and Liikanen models, not to mention the national reforms taken forward by Germany and France, is far from ideal. The case for seeking to create greater harmonisation of bank structural rules across the EU is thus, in theory, a strong one. Nevertheless, the political reality is that it will now be very difficult to reach agreement on the proposal. Whether the Commission and the co-legislators have either the commitment or the resolve to reach such an agreement is open to doubt.**

### The growth agenda

296. One of the overriding concerns of our witnesses was that the legislative framework had been focused too much on stability rather than growth.[379]

373 Written evidence from the Association for Financial Markets in Europe (FRF0012)

374 Written evidence from the International Regulatory Strategy Group (FRF0017)

375 Q 190

376 QQ 86, 99

377 Written evidence from Professor Rosa M Lastra (FRF0018)

378 Q 99

379 Q 81 (Benoit Lallemand), Q 126 (Mike Vercnocke) and Q 201 (Douglas Flint)

Peter Cosmetatos said that, in common with financial regulators across the world, the EU's "failure to act in the boom was followed by an inevitable backlash in the bust, reflecting understandable public hostility towards bankers and the world of finance. Eventually, policymakers remembered that, for all its sins, the finance industry had to be part of the solution in getting the economy moving again."[380]

297. On the other hand, Michel Barnier emphasised that financial stability was an essential precondition,[381] while the Bank of England highlighted that growth was best supported by a stable banking system.[382] Andrea Enria warned that capital was necessary to support bank lending and that it was risky to bend stability rules to support growth.[383]

298. Notwithstanding these arguments, there was consensus that there needed to be a renewed focus across the EU institutions on promoting economic growth to combat the fundamental problems of youth unemployment, inequalities between Member States and the looming threat of a deflationary spiral. David Lawton said that the best thing for growth would be to allow firms and regulators to get on with completing the job that was started over recent years.[384] Colin Tyler agreed that the key to economic growth was to remove uncertainty from business decision-making.[385]

299. The BBA criticised the way in which the focus on stability had only belatedly been matched by a recognition of the need to promote economic growth. They stated that infrastructure and export financing, a greater role for capital markets, revitalising the securitisation market and promoting alternative financing sources for SMEs could all help to promote a more diverse financing system. The BBA also called for an enhanced role for the European Investment Bank (EIB) in supporting cross-border and national infrastructure projects.[386]

300. AFME cited similar solutions, including simplifying and improving access to SME financing, the expansion of SME securitisation, the development of a pan-European private placement market, and infrastructure investment. AFME also argued that the European Long-Term Investment Fund (ELTIF) could be a means of making infrastructure investments accessible to a wider group of investors. They suggested that EIB eligibility criteria could be relaxed.[387]

301. Simon Gleeson said that one of the most useful things that the EU could do was to finish the ELTIF legislative architecture in order to provide a vehicle for financing to SMEs to flow (agreement between the Council and the European Parliament on the regulation was subsequently reached in

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380 Written evidence from Peter Cosmetatos (FRF0009)

381 QQ 101, 103

382 Q 264 (Andrew Bailey)

383 Q 181

384 Q 239

385 Q 224

386 Written evidence from the British Bankers' Association (FRF0015)

387 Written evidence from the Association for Financial Markets in Europe (FRF0012)

December 2014).[388] Wim Mijs agreed that the priority was providing equity to SMEs.[389]

302. On the other hand, the City of London Office in Brussels said that the real problem for the Commission's growth agenda was that the Commission did not control many of the levers which bear on issues like labour market structures. Structural reform remained a mainly national issue.[390] The IRSG agreed that many of the levers on the demand side were within Member State competence.[391] Standard Life conceded that it would be difficult to achieve growth through regulation alone.[392]

*An Investment Plan for Europe*

303. Notwithstanding these limitations, President Juncker stated that his first priority as Commission President would be to strengthen Europe's competitiveness and to stimulate investment for the purpose of job creation.

304. On 26 November 2014, the Commission published a Communication on 'An Investment Plan for Europe', setting out its proposals for the mobilisation of at least €315 billion in additional investment over the next three years. The scheme would use €21 billion in EU funds (€16 billion from the EU Budget and €5 billion from the EIB) as a guarantee to raise private cash in the capital markets.[393]

305. On 13 January 2015, the Commission published its legislative proposal for a European Fund for Strategic Investments, a European Investment Advisory Hub and a European Investment Project Pipeline.[394] The Commission hopes that the Fund will be operational by June 2015. We will scrutinise the proposals closely in the months ahead.

306. **The need for growth to be restored to the EU becomes more urgent by the day. Fears that the EU may slip yet again into recession have been exacerbated by the growing threat of a deflationary spiral. The Commission must do all it can to promote growth, in particular by promoting access to finance for SMEs. We welcome the fact that the co-legislators have reached agreement on the European Long-Term Investment Funds (ELTIFs) regulation.**

307. **The new Commission's efforts to promote a growth agenda through the proposed Investment Plan for Europe are also to be welcomed. But primary responsibility for restoring growth and competitiveness remains with Member States, who must promote growth-friendly policies, and press on with structural reforms and the completion of the Single Market. Creditor Member States have their own obligations to stimulate growth and demand.**

388 Q 51

389 Q 89

390 Q 132 (Mike Vercnocke)

391 Written evidence from the International Regulatory Strategy Group (FRF0017)

392 Written evidence from Standard Life (FRF0024)

393 Communication from the Commission: *An Investment Plan for Europe*, COM(2014) 903 FINAL

394 Proposal for a regulation of the European Parliament and of the Council on the European Fund for Strategic Investments and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013, COM(2015) 10 FINAL

## Capital Markets Union

308. The other major element of the new Commission's efforts to promote growth and competitiveness was its announcement of a 'Capital Markets Union'. In his letter of appointment to the new UK Commissioner, Lord Hill of Oareford, President Juncker tasked him with "bringing about a well-regulated and integrated Capital Markets Union, encompassing all Member States, by 2019, with a view to maximising the benefits of capital markets and non-bank financial institutions for the real economy."[395]

309. In a speech on 6 November 2014, Lord Hill outlined his intentions:

> "My ambition is clear: to help unlock the capital around Europe that is currently frozen and put it to work in support of Europe's businesses, particularly SMEs. And that is where the Capital Markets Union, a new frontier of Europe's Single Market, comes in … The situation at the moment is one of dis-unity; of fragmentation. Shareholders and buyers of corporate debt rarely go beyond their national borders when they invest. Savings are essentially compartmentalised in Member States, and are too concentrated in the banking system. This is holding back the size and depth of capital markets, making it difficult for investors to diversify. There are a number of reasons for this fragmentation. There are differing rules, documentation and market practices for products like securitised instruments, private placements or crowdfunding. There is the tax element, with a strong bias against equity and in favour of both corporate debt and mortgage debt. The national nature of insolvency law is another feature. And investors don't have access to comparable information on smaller businesses to assess the risk of investing across countries."[396]

310. We asked our witnesses to define what Capital Markets Union should entail. Michel Barnier said that his dream was of a real European capital market where projects could be funded fairly anywhere in Europe, taking into account the risks they posed rather than the country in which they were being carried out.[397] Karel Lannoo told us that Capital Markets Union did not mean another wave of regulation. Instead it was about ensuring that there was a true European capital market rather than a series of national capital markets next to each other.[398]

311. Anthony Browne said that Capital Markets Union included promoting securitisation, improving direct access to the securities market for mid-sized companies and further reforms to promote cross-border investment and clearing within Europe.[399] The City of London Office in Brussels understood it to involve private placement, creating more of a securitisation market in

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[395] Mission letter from Jean-Claude Juncker, President of the European Commission to Lord Hill of Oareford, Commissioner for Financial Stability, Financial Services and Capital Markets Union (1 November 2014): http://ec.europa.eu/commission/sites/cwt/files/commissioner_mission_letters/hill_en.pdf [accessed 9 January 2015]

[396] Speech by Lord Hill of Oareford, Commissioner for Financial Stability, Financial Services and Capital Markets Union, 'Capital Markets Union—finance serving the economy' (6 November 2014): http://europa.eu/rapid/press-release_SPEECH-14-1460_en.htm [accessed 9 January 2015]

[397] Q 110

[398] Q 67

[399] Q 197

Europe, increasing access for SMEs to capital markets and the whole issue of long-term infrastructure finance. They were concerned about the extent to which this would require some sort of EU-level oversight.[400] It remains to be seen what role ESMA will be given in that regard.

312. David Lawton thought that a review of the Prospectus Directive[401] could play a key role in the context of Capital Markets Union in terms of seeing whether some of the required prospectus disclosures could be more streamlined, particularly for SMEs.[402] Christopher Woolard called for some basic minimum standards for crowdfunding because "the regulatory regime around that is pretty murky".[403]

313. Several of our witnesses stressed the opportunities that Capital Markets Union created for the UK. The City of London Office in Brussels thought that it was potentially very positive for the City given the scale of business and expertise there.[404] Likewise Sharon Bowles saw it as "a tremendous opportunity for the UK as the major centre of capital markets."[405] The Minister saw a huge opportunity in what she referred to as the Single Market for capital for a growth and jobs agenda not a "regulate and shut down" agenda.[406]

314. A Commission Green Paper on Capital Markets Union is expected to be published shortly. We will scrutinise its proposals in more detail in a forthcoming report.

315. **We welcome the concept of Capital Markets Union, which has the potential to be an important and necessary initiative by the Commission, and a logical step towards completion of the Single Market. Opening up the EU's capital markets is a fundamental means of countering the overreliance on bank funding in the EU, and of enabling SMEs to access finance in a more effective way. Capital Markets Union provides an ideal opportunity for addressing securities law, reviewing the Prospectus Directive and considering the role of crowdfunding as a funding tool. Nevertheless, we caution against Capital Markets Union being used as a justification for a further wave of legislation.**

316. **Capital Markets Union presents a golden opportunity for the UK to promote the importance of capital markets, as an alternative to bank funding, in the functioning of the EU economy. It is therefore imperative that the Government ensures that the UK is at the front and centre of the debate about Capital Markets Union in the months ahead. It also provides a means to demonstrate afresh that the City of**

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400 Q 122 (Mike Vercnocke)

401 The Prospectus Directive governs the prospectus required of issuers when they raise funds by means of a public offer of securities or through admitting their securities to a regulated market in the EU. The Directive is accordingly a cornerstone of EU capital markets regulation. It was last amended in 2010 and is due to be reviewed by January 2016.

402 Q 235

403 *Ibid*. Crowdfunding can take a number of forms, but is based on the raising of capital, in small increments, from large numbers of people, and for a specific purpose.

404 Q 122 (Mike Vercnocke)

405 Q 14

406 Q 271

**London, and the financial sector which is centred there, is an asset not only to the UK economy but to the EU as a whole.**

## Overview

317. **The post-2008 financial crisis was the most severe in living memory, and its effect is still being felt today. The ramifications for the EU have been particularly acute, and the 41 legislative proposals have brought about a radical transformation in the EU financial sector regulatory framework. Given the scale of the task they faced in responding to a once-in-a-generation crisis, the EU institutions have performed well in achieving significant reform of the framework. Yet that regulatory framework inevitably contains some weaknesses. The role of the ESAs needs to be strengthened. Some regulatory reforms were the result of political pressures to take prompt action, and/or to make the financial sector pay for the crisis. The need to promote the growth agenda was only belatedly recognised. There was not enough recognition of the cumulative impact of the reforms on the financial sector.**

318. **It was also inevitable, given the amount of new legislation, its broad range and the speed of its introduction, that there would be a number of inconsistencies, rough edges and elements which, with the benefit of hindsight, were disproportionate or even misguided. We welcome the commitment of the new European Commissioner for Financial Stability, Financial Services and Capital Markets Union, Lord Hill of Oareford, to "look not just at individual measures where reviews are already written in to European legislation, but at the cumulative effect of the different pieces of legislation."[407] With that commitment in mind, we recommend that the Commission launches a thoroughgoing internal audit of the entire legislative framework to date, with a view to making recommendations both to remedy those key weaknesses in the current framework and to point up lessons learned in handling the crisis which might be applied in any future crisis of similar magnitude.**

319. **The coming months and years provide an opportunity to take stock and to ensure effective implementation of the reforms that have already been introduced. Yet the financial sector will not stand still, and the regulatory framework will need to keep up. The economic challenges facing the EU are immense. In that vein we welcome the Commission's proposals for an Investment Plan for Europe and for a Capital Markets Union. Yet the responsibility for promoting growth and prosperity lies not only with the Commission and the EU institutions but with every Member State. There can be no excuse for a failure to act.**

[407] Speech by Lord Hill of Oareford, 6 November 2014

# APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

## Members

Lord Balfe
Viscount Brookeborough
The Earl of Caithness
Lord Carter of Coles
Lord Davies of Stamford
Lord Dear
Lord Flight
Lord Hamilton of Epsom
Lord Harrison (Chairman)
Lord Kerr of Kinlochard
Lord Shutt of Greetland
Lord Vallance of Tummel

## Declarations of interest

Lord Balfe
*Specialist Director, CERN Pension Fund; a fee is paid per meeting attended plus travel, hotel and any other incidental expenses.*
*Chairman, European Parliament Members' Pension Fund*
*Shareholdings in: Hargreaves Lansdown, Diageo, Reckitt Benckiser, Rio Tinto, Astra Zeneca, GlaxoSmithKline PLC, Smith and Nephew, Law Debenture*
*Speaking Engagement, 12 May 2014; chaired Annual Conference of Law Debenture UK*

Viscount Brookeborough
*No relevant interests declared*

The Earl of Caithness
*Consultant, Rickett Tinne Estate Agents*
*Share Portfolio managed by JM Finn & Co on a fully discretionary basis*
*Guest at lunch hosted by British Bankers' Association, 17 July 2014*
*Guest at lunch hosted by Swiss Bankers' Association, 19 November 2014*

Lord Carter of Coles
*Director, JKHC Ltd*
*Director, Health Services Laboratories LLP*
*Director, Primary Group Ltd, and also of the following subsidiary companies: PGUK HAB Ltd; Qmetric Group Ltd; UK General Insurance Ltd; UK General Insurance Group Ltd*
*Chair, NHS Procurement & Efficiency Board*
*Adviser, Warburg Pincus International Ltd*
*Shareholdings in: JKHC Ltd (business services), The Glenholme Healthcare Group Ltd (care and rehabilitation centres), Diageo PLC (drinks), Imperial Tobacco Group PLC (tobacco), IMI PLC (engineering solutions), Compass Group PLC (catering), HSBC Holdings PLC (banking/financial), Pearson PLC (education), Prudential PLC (insurance), Lloyds Banking Group PLC (financial), BG Group PLC (gas), GlaxoSmithKline PLC (pharmaceuticals), Weir Group PLC (engineering solutions), Verizon Communications Inc (telecommunications), JP Morgan Chase & Co (financial), Home Depot*

*Inc (retail), Johnson & Johnson (retail), CVS Caremark Corporation (pharmaceuticals), United Technologies Corp (technology), Deutsche Post AG-REG (logistics), BASF SE (chemicals), Banco Bilbao Vizcaya Argenta Euro.49 (corporate bond), Nestle SA (food/retail), ING Group (insurance), Google Inc-CL A (technology), Royal Dutch Shell (oil and gas), Inmarsat PLC (satellite communication), Unilever PLC (retail), Vodafone Group PLC (telecommunications), Whitbread PLC (retail), Visa Inc (financial), United Utilities Group PLC (utilities), EOG Resources Inc (aerospace/defence), WPP PLC (advertising), United Rentals Inc (rental company), Caledonia Investments PLC (investments), GW Pharmaceuticals PLC, McKesson Corp (IT HR and payroll), GlobalAccess Global High Yield Bond Fund M Distribution GBP, Jupiter Strategic Bond Fund 05–perp pref shsl, FRN Barclays Bank PLC (corporate bond), 2% Canadian Government Bond Snr 01 Dec 14 (government bond), Polar Capital Global Technology Inst GBP Inst (fund), Henderson European Special Situations GBP Inc Inst (fund), GlobalAccess US Small & Mid Cap Equity Fund (M Distribution USD), Findlay Par, American Smaller Cos USD (fund), Schroder UK Opportunities Z Acc GBP (fund), Brown Advisory FDS American Dollar CLS B USD (fund), Mondelez International Inc-A (fund), Martin Currie UT China B ACC Nav (fund), Newton Asian Income Institutional W GBP Inc (fund), iShares FTSE EPRA/NAREIT Asia Property Yield Fund, First State Asia Pacific Leaders B GBP Acc (fund), GlobalAccess Global High Yield Bond Fund M Accumulation GBP, Safran SA (aerospace/defence), Google Inc-CL L (technology)*
*Chair, Property Advisory Panel*
*Member, Efficiency and Reform Board*

Lord Davies of Stamford
*Shareholding in HSBC*

Lord Dear
*No relevant interests declared*

Lord Flight
*Chairman, Aurora Investment Trust PLC*
*Director, Edge Performance VCT PLC*
*Chairman, Flight & Partners Limited*
*Director, Investec Asset Management Limited*
*Chairman, CIM Investment Management Limited*
*Chairman and shareholder, Downing Structured Opportunities VTCI PLC*
*Director, Metro Bank PLC*
*Director, Marechale Capital*
*Director, Investec Asset Management Holdings (Pty) Limited*
*Director, R5 FX Limited*
*Commissioner, Guernsey Financial Services Commission*
*Consultant, Kinetic Partners*
*Trustee, IAM Pension Fund*
*Consultant, Tax Incentivised Savings Association (TISA)*
*Chairman, EIS Association*
*Consultant, Arden Partners*
*Member Investment Committee, Guinness Renewable Energy EIS Fund*
*As Chairman, EIS Association (representative body for lawyers, accountants, promoters of EIS qualifying companies), public affairs advice is provided to the Association*

*As Consultant to TISA (representative body for retail investment management industry), public affairs advice is provided to TISA*
*Shareholdings in: Flight & Partners Limited, Flight & Partners Recovery Fund, Metro Bank PLC*
*Director, Flight & Barr Limited (dormant company)*
*Director, Gulf Overseas Investment Fund Limited (private investment fund)*
*Member of Advisory Board Praesidian Capital Europe*
*Member of Advisory Board, Centre for Policy Studies*
*Member of Advisory Board, Institute of Economic Affairs*
*Member of Advisory Board, Financial Services Forum*

Lord Hamilton of Epsom
*Non-Executive Director, Jupiter Dividend and Growth Trust PLC*
*Director, IREF Global Holdings (Bermuda) Ltd*
*Director, IREF Australian Holdings (Bermuda) Ltd*
*Director, AREF Holdings (Bermuda) Ltd*
*Director, Sovereign Business Jets*
*Shareholdings in: Nordea Bank AB (banking), Findlay Park American Fund, Hermes International Fund, Powershares Exchange Traded FD Buyback Achievers*
*Share portfolio managed by JP Morgan American IT on a fully discretionary basis*
*Share portfolio managed by Findlay Park American FDS on a fully discretionary basis*

Lord Harrison (Chairman)
*Vice President, Wirral Investment Network (WIN)*
*Guest at lunch hosted by British Bankers' Association, 17 July 2014*

Lord Kerr of Kinlochard
*Deputy Chairman and shareholder, Scottish Power PLC*
*Non-executive Director and shareholder, Rio Tinto PLC*
*Non-executive Director, Rio Tinto Ltd (Australia)*
*Director and shareholder, Scottish American Investment Co Ltd*
*Member, International Advisory Board, Edinburgh Partners*
*Shareholding in Royal Dutch Shell PLC*
*Shareholding in European Investment Trust*
*Chairman, Centre for European Reform*
*Vice President, European Policy Centre*
*Council Member, BNE (London)*
*Council Member, BI (London)*

Lord Shutt of Greetland
*Chartered Accountant (non-practising)*
*Shareholding in Bank of Ireland (spouse)*
*Guest at lunch hosted by Swiss Bankers' Association, 19 November 2014*

Lord Vallance of Tummel
*Chairman, Amsphere Ltd*
*Chairman, De Facto 479 Ltd (family owned investment company)*
*Member, International Advisory Board, Allianz SE*
*Chairman, Board of Royal Conservatoire of Scotland (RCS)*
*Share portfolio managed by Smith & Williamson on a fully discretionary basis*

The following Members of the European Union Committee attended the meeting at which the report was approved:

Lord Boswell of Aynho (Chairman)
The Earl of Caithness
Lord Cameron of Dillington
Lord Foulkes of Cumnock
Lord Harrison
Baroness Henig
Baroness Hooper
Lord Kerr of Kinlochard
Lord Maclennan of Rogart
Baroness O'Cathain
Baroness Parminter
Baroness Prashar
Baroness Quin
The Earl of Sandwich
Baroness Scott of Needham Market
Lord Tugendhat
Lord Wilson of Tillyorn

During consideration of the report the following Members declared an interest:

Lord Boswell of Aynho (Chairman)
*Shareholdings in two financial services companies (Barclays and Allianz)*
Lord Cameron of Dillington
*A portfolio of shares managed by Sarasins*
Baroness Henig
*Chairman-elect, Phinancial Ltd (financial services company)*
Baroness O'Cathain
*Holder of several financial products with HSBC*
Lord Tugendhat
*Shareholdings in: A portfolio of investment vehicles managed on behalf of member and his wife and at their discretion by Coutts & Co; A portfolio of mainly but not exclusively US$ denominated funds, fixed interest stocks, preference shares and equity held and managed on behalf of member and his wife by Royal Bank of Canada, that includes: Barclays Bank PLC, HSBC Holdings Brazil SA (banking), Lloyds Bank PLC, Morgan Stanley Capital (banking), Marks and Spencer PLC (retail), Royal Bank of Canada (banking), Volkswagen International (automotive), ETFS Commodity Securities (alternative investment vehicle dealing in crude oil); Rio Tinto (mining); Biotech Growth Trust (biotech investment trust)*
*SIPP managed on member's behalf and at their discretion by Standard Life*
*Term deposits with Coutts & Co, and Nationwide Building Society*
*Member, Advisory Council, Trilantic Capital Partnership, which invests in business in which Member sometimes takes a stake*
*Member of Advisory Council, Official Monetary and Financial Institutions Forum Limited (independent research and advisory group and a platform for confidential exchanges of views between official institutions and private sector counterparties)*

A full list of Members' interests can be found in the Register of Lords' Interests: http://parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/

Professor Niamh Moloney acted as Specialist Adviser for this inquiry and declared the following relevant interests:

*Academic Member, Securities and Markets Stakeholder Group, European Securities and Markets Authority (ESMA)*
*Member, Consumer Advisory Group, Central Bank of Ireland*
*Former Member, Financial Services Consumer Panel, Financial Conduct Authority*

## APPENDIX 2: LIST OF WITNESSES

Evidence is published online at http://www.parliament.uk/eu-financial-regulatory-framework and available for inspection at the Parliamentary Archives (020 7219 3074).

Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with ** gave both oral evidence and written evidence. Those marked with * gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

### Oral evidence in chronological order

| | | |
|---|---|---|
| * | Sharon Bowles, former Chair of the European Parliament Economic and Monetary Affairs (ECON) Committee | QQ 1–25 |
| * | Professor Lucia Quaglia, Professor of Political Science, University of York | QQ 26–44 |
| * | Professor Kern Alexander, Chair for Law and Finance, University of Zurich and Senior Research Associate, Centre for Financial Analysis & Policy and Cambridge Judge Business School, University of Cambridge | |
| * | Nicholas Véron, Senior Fellow at Bruegel and Visiting Fellow at the Peterson Institute for International Economics | QQ 45–61 |
| * | Professor Simon Gleeson, Partner at Clifford Chance, London | |
| * | Karel Lannoo, Chief Executive Officer, Centre for European Policy Studies | QQ 62–79 |
| * | Benoit Lallemand, Acting Secretary-General, Finance Watch | QQ 80–100 |
| * | Wim Mijs, Chief Executive, European Banking Federation | |
| * | Michel Barnier, Commissioner for Internal Market and Services, European Commission | QQ 101–115 |
| * | Mike Vercnocke, Head of Office, City of London Office in Brussels | QQ 116–139 |
| * | Elizabeth Gillam, Deputy Head of Office, City of London Office in Brussels | |
| * | Dr Kay Swinburne MEP | QQ 140–156 |
| * | Richard Corbett MEP | QQ 157–174 |
| * | Andrea Enria, Chairperson, European Banking Authority | QQ 175–186 |
| ** | Anthony Browne, Chief Executive, British Bankers' Association | QQ 187–198 |
| ** | Sally Dewar, Managing Director, JP Morgan | |
| * | Douglas Flint, Group Chairman, HSBC Holdings plc | QQ 199–214 |

| | | |
|---|---|---|
| ** | Sue Lewis, Chair, Financial Services Consumer Panel | QQ 215–228 |
| * | Colin Tyler, Chief Executive, Association of Corporate Treasurers | |
| ** | David Lawton, Director of Markets, Financial Conduct Authority (FCA) | QQ 229–240 |
| ** | Christopher Woolard, Director of Policy, Financial Conduct Authority (FCA) | |
| * | Verena Ross, Executive Director, European Securities and Markets Authority (ESMA) | QQ 241–251 |
| * | Andrew Bailey, Deputy Governor for Prudential Regulation, Bank of England | QQ 252–269 |
| * | Sir Jon Cunliffe, Deputy Governor for Financial Stability, Bank of England | |
| * | David Rule, Executive Director, Prudential Policy, Prudential Regulation Authority (PRA), Bank of England | |
| ** | Andrea Leadsom MP, Economic Secretary to the Treasury | QQ 270–289 |
| ** | Katherine Braddick, Director, Financial Services, HM Treasury | |

## Alphabetical list of all witnesses

| | | |
|---|---|---|
| | Aberdeen Asset Management PLC (AAM) | FRF0022 |
| * | Professor Kern Alexander (QQ 26–44) | |
| * | Colin Tyler, Association of Corporate Treasurers (QQ 215–228) | |
| | Association for Financial Markets in Europe (AFME) | FRF0012 |
| | Aztec Group | FRF0002 |
| * | Andrew Bailey, Bank of England (QQ 252–269) | |
| * | Sir Jon Cunliffe, Bank of England (QQ 252–269) | |
| | Graham Bishop | FRF0006 |
| * | Sharon Bowles (QQ 1–25) | |
| * | Anthony Browne, British Bankers' Association (QQ 187–198) | |
| ** | British Bankers' Association (BBA) | FRF0015 |
| | British Private Equity and Venture Capital Association | FRF0010 |
| | British Property Federation (BPF) | FRF0008 |
| | Lord Butler of Brockwell | FRF0027 |
| * | Nicholas Véron, Bruegel and Peterson Institute for International Economics (QQ 45–61) | |
| | Building Societies Association | FRF0004 |

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|---|---|---|
| * | Karel Lannoo, Centre for European Policy Studies (QQ 62–79) | |
| | Centre for International Governance Innovation (CIGI) | FRF0013 |
| * | Elizabeth Gillam, City of London Office in Brussels (QQ 116–139) | |
| * | Mike Vercnocke, City of London Office in Brussels (QQ 116–139) | |
| * | Professor Simon Gleeson, Clifford Chance (QQ 45–61) | |
| | Tim Congdon | FRF0021 |
| * | Richard Corbett MEP (QQ 157–174) | |
| | Peter Cosmetatos | FRF0009 |
| * | Andrea Enria, European Banking Authority (QQ 174–186) | |
| * | Wim Mijs, European Banking Federation (QQ 80–100) | |
| * | Michel Barnier, European Commission (QQ 101–115) | |
| * | Verena Ross, European Securities and Markets Authority (ESMA) (QQ 241–251) | |
| ** | David Lawton, Financial Conduct Authority (FCA) (QQ 229–240) | FRF0030 |
| ** | Christopher Woolard, Financial Conduct Authority (FCA) (QQ 229–240) | FRF0030 |
| | Financial Markets Law Committee (FMLC) | FRF0023 |
| ** | Sue Lewis, Financial Services Consumer Panel (QQ 215–228) | |
| ** | Financial Services Consumer Panel | FRF0007 FRF0028 |
| * | Benoit Lallemand, Finance Watch (QQ 80–100) | |
| | Christos VI. Gortsos | FRF0011 |
| * | Katherine Braddick, HM Treasury (QQ 270–289) | |
| ** | Andrea Leadsom MP, Economic Secretary to HM Treasury (QQ 270–289) | FRF0029 |
| * | Douglas Flint, HSBC Holdings PLC (QQ 199–214) | |
| | International Regulatory Strategy Group | FRF0017 |
| | Investment Management Association | FRF0025 |
| ** | Sally Dewar. JP Morgan (QQ 187–198) | FRF0026 |
| | Professor Rosa M Lastra | FRF0018 |
| | Professor Alistair Milne | FRF0016 |
| | Chiara Oldani | FRF0019 |

| | | |
|---|---|---|
| * | David Rule, Prudential Regulation Authority (PRA) (QQ 252–269) | |
| * | Professor Lucia Quaglia (QQ 26–44) | |
| | Seimas of The Republic of Lithuania Committee on European Affairs | FRF0020 |
| | Standard Life | FRF0024 |
| * | Dr Kay Swinburne MEP (QQ 140–156) | |
| | Professor Leila Simona Talani | FRF0003 |
| | Wealth Management Association (WMA) | FRF0014 |

## APPENDIX 3: CALL FOR EVIDENCE

The House of Lords EU Economic and Financial Affairs Sub-Committee, chaired by Lord Harrison, is conducting an inquiry into the current state of the EU financial regulatory framework. The Committee invites interested individuals and organisations to submit evidence to this inquiry.

Written evidence is sought by 30 September 2014. Public hearings will be held from July–October 2014. The Committee aims to report to the House, with recommendations, in January 2015. The report will receive a response from the Government, and may be debated in the House.

### Background

The pace of reform since the start of the financial crisis in 2007 has transformed the EU financial regulatory architecture. The changes that have been introduced have sought not only to improve the economic governance of EU Member States but also to strengthen the supervisory and regulatory oversight of financial markets and institutions themselves. These regulations have been based largely on the ambitious G20 commitments set by international partners in Pittsburgh in 2009.

The UK Government has made it clear that it supports improving the strength of the EU regulatory architecture and is committed to the Single Market in financial services. The Commission has stated that the majority of reforms have now been agreed, and the financial industry in Europe is now focusing on effective implementation and co-ordination across Member States. It is therefore an opportune moment to step back and assess the strengths and weaknesses of the new regulatory framework and how agreed and proposed regulations interact with each other.

As financial actors in the EU adapt to a fast-evolving financial landscape it is important to understand the regulatory interconnections that have been built to bolster integrity, transparency, stability and efficiency in the EU financial sector. Concerns remain that certain clusters of regulations have led to conflicting requirements or left gaps in the regulation of similar activities. Building on the work already undertaken by the Commission (in its May 2014 *Economic Review of the Financial Regulation Agenda*) and the European Parliament (in its February 2014 report on *Enhancing the coherence of EU financial services legislation*), this inquiry is an opportunity to:

- Take stock of the progress made in reforming the financial system;
- Assess the functioning of the financial regulatory framework as a whole and its impact on financial sector actors and consumers alike;
- Acknowledge any gaps, overlaps or inconsistencies in the regulatory framework;
- Seek to ensure that adverse consequences and unnecessary complexities do not undermine the functioning of the Single Market in financial services; and
- Analyse the specific implications and challenges of the financial regulatory framework for the UK.

## Issues

The Committee seeks evidence on any aspect of this topic, and particularly on the following questions:

*Broad assessment of the EU regulatory framework*

1. What is your overall assessment of the reforms brought forward since 2008 that have aimed to stabilise and improve the functioning of the financial sector in Europe? What is the basis for your assessment?
2. Will the new regulatory framework enable the EU to withstand further asymmetric shocks and future crises as yet unforeseen? Is there sufficient flexibility in place to enable it to do so?
3. Where do you think the biggest achievements have been made, and why? Do you believe there have been any obvious policy mistakes in the regulatory agenda? What are the relative benefits and costs of the new regulatory framework?
4. Which elements of the reforms have been most and least effective in addressing: consumer protection; market efficiency, transparency and integrity; and financial stability?
5. How would you assess the effectiveness of the legislative process over the course of the financial crisis? Which EU institutions were most or least effective? In your view, were financial regulatory proposals improved or weakened by the input of the Council and the European Parliament?
6. How do you think the 'growth agenda' and support of alternative financing sources can best be promoted by the EU with respect to regulation?

*Interconnections, overlaps and gaps in the EU regulatory agenda*

7. Do you identify any overlaps, contradictions or inconsistencies when assessing and comparing individual pieces of the regulatory agenda? Which combination of reforms has generated the most significant costs and inefficiencies for financial actors?
8. Do areas of the regulatory agenda need immediate revision/reform? If so, how might the effectiveness of the review clauses which apply to the new measures be best ensured? How can it be ensured that there are mechanisms in place to fine-tune the regulatory system where necessary without disrupting financial stability and predictability for financial users? Should there be a period of calm before further reforms are introduced?
9. The Commission argues that the new and/ or forthcoming proposals on Bank Structural Reform, Shadow Banking, Benchmark Regulation and Non-bank Resolution further complete the financial sector reform agenda. Do you agree? If not, which policy gaps remain?
10. Have the needs of consumers of financial services and products been appropriately addressed by the reform process? Do particular risks in relation to consumer protection arise from the reforms?
11. How concerned should we be about the range of unintended consequences from such regulation—such as regulatory arbitrage and transferring risk off balance sheet?

*The EU Single Rulebook and the consequences for the Single Market*

12. Is there now an effective balance between Member States and the EU in terms of regulation and supervision of the financial sector? If not, how can such an effective balance be struck?
13. Is the EU process for adopting rules efficient and nimble enough to adjust and calibrate the new Single Rulebook? Which single element of the new Rulebook is in most acute need of careful monitoring and review?
14. What is your assessment of the impact of the new Rulebook on third-country actor access to the EU and of the approach taken to 'equivalence'? Is there a danger of 'multiple jeopardy' arising from the multiplicity of regulatory regimes across the EU and beyond?
15. In light of the fact that some of the regulatory framework applies at EU-28 level, and other elements for the eurozone only, is there a danger of a two-speed or inconsistent approach to regulation?

*The implications for the UK*

16. What are the challenges of the regulatory reform agenda for non-eurozone Member States? In particular, which specific challenges does the UK face? How has its approach to the regulatory reform agenda compared with that of other non-eurozone Member States such as Sweden and Denmark, as well as those such as Poland who are required to join the Single Currency in due course?
17. Overall, do you believe that the UK's interests have been compromised or enhanced by the programme of regulatory reforms? Has the UK done enough to protect its national interests?

16 July 2014

## APPENDIX 4: SUMMARY OF MAJOR EU FINANCIAL SECTOR LEGISLATIVE REFORMS

| Measure | Year | Broad Category of Reform[408] | Purpose/Main Content of Measure | In force[409] |
|---|---|---|---|---|
| Bank Recovery and Resolution Directive (BRRD) | 2014 | Direct Response to Financial Crisis: Financial Stability/Prudential Regulation | Rules governing the recovery and resolution of financial institutions (banks and certain investment firms) and related resolution funds | 2015 and 2016[410] |
| Single Resolution Mechanism Regulation (SRM) | 2014 | Banking Union | Establishment and operation of Banking Union's Single Resolution Mechanism | 2016[411] |
| Markets in Financial Instruments Directive II (MiFID II)/Markets in Financial Instruments Regulation (MiFIR) | 2014 | Direct Response to Financial Crisis: Financial Stability/Prudential Regulation and Securities and Derivatives Market Regulation | Enhanced regulation of investment firms and trading venues (reforming MiFID I) and including a trading obligation for certain derivatives | 2017[412] |
| Packaged Retail and Insurance-Based Investment Products Regulation (PRIIPs) | 2014 | Supporting a Stable Responsible and Efficient Financial Sector: the Retail Markets | Rules governing a standardised information sheet for certain investment products | Likely 2016 |
| Single Supervisory Mechanism (SSM)/ECB Regulation | 2013 | Banking Union | Establishment and operation of the Single Supervisory Mechanism and powers of the ECB | 2013 and 2014[413] |

408 Based in part on the Commission's classification of crisis-era measures contained in Commission Staff Working Document: Economic Review of the Financial Regulation Agenda, SWD (2014) 158 FINAL

409 In force dates (which relate to when a measure must be applied) are approximate as measures typically stagger the dates at which some aspects of the measure in question come into force.

410 The 'bail in' rules apply from 2016.

411 While the main part of the Regulation comes into force in 2016, a number of provisions relating to the establishment of the SRM apply over 2014–15.

412 A range of transitional arrangements apply to the full application of MiFID II/MiFIR, with some provisions not applying until 2019–20.

| Measure | Year | Broad Category of Reform | Purpose/Main Content of Measure | In force |
|---|---|---|---|---|
| Capital Requirements Directive (CRD IV)/Capital Requirements Regulation (CRR) | 2013 | Direct Response to Financial Crisis: Financial Stability/Prudential Regulation | Implementation of Basel III Agreement; single rulebook governing bank capital, leverage, and liquidity, and governing bank governance and risk management, including remuneration | 2013[414] |
| Credit Rating Agency (CRA) Regulations I, II, and III | 2009 (I), 2011 (II) and 2013 (III) | Direct Response to Financial Crisis: Financial Stability/Prudential Regulation | Rules governing the authorisation and regulation of rating agencies and their supervision by ESMA, and including rules relating to sovereign debt ratings and securitisations | 2013, 2011, and 2009, respectively . |
| Market Abuse Regulation (MAR) and Market Abuse (Criminal Sanctions) Directive (CSMAD) | 2014 | Direct Response to Financial Crisis: Prevention of Market Abuse | Enhancement of 2003 Market Abuse Directive regime, including by expanding its scope (Regulation); imposition of new requirement for mandatory criminal sanctions (Directive) | 2016 |
| European Market Infrastructure Regulation (EMIR) | 2012 | Direct Response to Financial Crisis: Financial Stability/Prudential Regulation | Rules governing the OTC derivatives markets including the clearing through CCPs of OTC derivatives and related risk management requirements, and transparency rules governing all derivatives | 2012[415] |
| Short Selling Regulation (SSR) | 2012 | Supporting a Stable Responsible and Efficient Financial Sector: Securities and Derivatives Markets | Rules governing short selling and transactions in credit default swaps, including reporting requirements and regulatory powers of intervention and prohibition | 2012 |

[413] While the governing legal regime came into force in 2013, the SSM did not become operational until November 2014.

[414] A range of transitional arrangements apply to the full application of CRD IV/CRR, with some provisions not applying until 2016–19.

[415] EMIR's full application is the subject of a range of transitional arrangements and, in parts, contingent on action by ESMA.

| **Measure** | **Year** | **Broad Category of Reform** | **Purpose/Main Content of Measure** | **In force** |
|---|---|---|---|---|
| Alternative Investment Fund Managers Directive (AIFMD) | 2011 | Direct Response to Financial Crisis: Financial Stability/Prudential Regulation | Rules governing fund managers of non-UCITS funds, including authorisation, risk management, leverage, liquidity, and transparency | 2013[416] |
| European Supervisory Authorities (ESAs) (EBA, ESMA, and EIOPA) Regulations | 2010 | Supporting a Stable Responsible and Efficient Financial Sector: Institution Building | Establishment and powers of the ESAs | 2011 |
| European Systemic Risk Board (ESRB) Regulation | 2010 | Supporting a Stable Responsible and Efficient Financial Sector: Institution Building | Establishment and powers of the ESRB | 2011 |

[416] Transitional arrangements apply to the third country access provisions.

## APPENDIX 5: GLOSSARY

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|---|---|
| ADR | Alternative Dispute Resolution |
| AFME | Association for Financial Markets in Europe |
| AIFMD | Alternative Investment Fund Managers Directive |
| AIFs | Alternative Investment Funds |
| AQR | Asset Quality Review |
| Basel II/Basel III | Sets of banking regulations put forward by the Basel Committee on Banking Supervision |
| BBA | British Bankers' Association |
| BCBS | Basel Committee on Banking Supervision |
| BRRD | Bank Recovery and Resolution Directive |
| BVCA | British Private Equity and Venture Capital Association |
| CCP | Central Counterparty Clearing House |
| CJEU | Court of Justice of the European Union |
| COREP | Common Reporting |
| COREPER | Committee of Permanent Representatives in the European Union |
| CRA | Credit Rating Agency |
| CRD | Capital Requirements Directive |
| CRR | Capital Requirements Regulation |
| CSMAD | Market Abuse (Criminal Sanctions) Directive |
| CSD | Central Securities Depositary |
| DG MARKT | Internal Market and Services Directorate General |
| EBA | European Banking Authority |
| ECB | European Central Bank |
| ECOFIN | Economic and Financial Affairs Council |
| ECON | European Parliament Economic and Monetary Affairs Committee |
| EIB | European Investment Bank |
| EIOPA | European Insurance and Occupational Pensions Authority |
| ELTIF | European Long-Term Investment Fund |
| EMIR | European Market Infrastructure Regulation |
| ESAs | European Supervisory Authorities |
| ESFS | European System of Financial Supervision |
| ESMA | European Securities and Markets Authority |
| ESRB | European Systemic Risk Board |
| EU | European Union |

| | |
|---|---|
| Eurogroup | An informal body bringing together the finance ministers of countries whose currency is the euro |
| FCA | Financial Conduct Authority |
| FINREP | Financial Reporting |
| FPC | Financial Policy Committee of the Bank of England |
| FSB | Financial Stability Board |
| FTT | Financial Transaction Tax |
| FX | Foreign Exchange |
| G20 | The Group of 20, comprising 19 of the world's largest national economies and the European Union |
| G-SIBs | Global Systemically Important Banks |
| G-SIIs | Global Systemically Important Insurers |
| IASB | International Accounting Standards Board |
| IFRS | International Financial Reporting Standards |
| IMD | Insurance Mediation Directive |
| IOSCO | International Organization of Securities Commissions |
| IRSG | International Regulatory Strategy Group |
| LCR | Liquidity Cover Ratio |
| MAR | Market Abuse Regulation |
| MEP | Member of the European Parliament |
| MiFID | Markets in Financial Instruments Directive |
| MiFIR | Markets in Financial Instruments Regulation |
| MMF | Money Market Fund |
| MP | Member of Parliament |
| NCA | National Competent Authority |
| OTC | Over-the-counter |
| PRA | Prudential Regulation Authority |
| PRIIPs | Packaged Retail and Insurance-Based Investment Products Regulation |
| PRIPs | Packaged Retail Investment Products Regulation |
| Repo | Securities repurchase |
| SIFI | Systemically Important Financial Institutions |
| SMEs | Small and Medium-sized Enterprises |
| SRM | Single Resolution Mechanism |
| SSB | Standard-Setting Body |
| SSM | Single Supervisory Mechanism |
| SSR | Short Selling Regulation |
| TEU | Treaty on European Union |

| | |
|---|---|
| TFEU | Treaty on the Functioning of the European Union |
| TTIP | Transatlantic Trade and Investment Partnership |
| UCITS | Undertakings for Collective Investment in Transferable Securities |