U.S. CHAMBER OF COMMERCE

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Commissioner Jonathan Hill
European Commission
Directorate-General for Financial Stability,
Financial Services, and Capital Markets Union
SPA2 03/071
1049 Brussels
Belgium

Dear Commissioner Hill:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region. We believe that a robust, balanced, and appropriate regulatory and legislative framework is fundamental to the development of liquid, deep, and efficient international capital markets.

Recently, we have welcomed the launch of the Capital Markets Union ("CMU") Action Plan, which has the potential to deepen, strengthen, and diversify European capital markets to the benefit of the economy as a whole. In the framework of CMU, we have particularly appreciated, after a number of years of significant and important financial services policymaking at European level, the inclusion of a work stream on assessing the cumulative impact of existing legislation.

With this letter we would thus like to share some perspectives with you in the framework of the European Commission call for evidence on the EU regulatory framework for financial services (the "Call for Evidence"). We believe that this exercise is extremely important to properly understand the interaction of the many rules, and their individual and cumulative impact. Going forward, a comprehensive, holistic view of EU financial services regulation should be adopted, with a particular focus on the key CMU objectives and Europe's global competitiveness.

Given the nature of the Chamber and our diverse membership, we have thought to provide a few practical examples and suggestions related to the four big themes around which the call for evidence is built, namely i) rules affecting the ability of the economy to finance itself and grow; ii) unnecessary regulatory burdens; iii) interactions of individual rules, inconsistencies, and gaps; and iv) rules giving rise to possible other unintended consequences. We also believe that our recent report, *International Financial Markets: A Diverse System is the Key to Commerce*, may be useful to you as you move forward with a review of responses to the Call for Evidence. We hope that our input will be helpful to you in making rulemaking decisions that benefit financial markets and the broader economy.

It should be stressed that, in many of these areas, it may still be too early to properly assess the impact of the rules. Only some legislation is already in force (e.g., Capital Requirements Directive IV, Bank Recovery and Resolution Directive, European Market Infrastructure Regulation, Solvency II, etc.), many pieces have been finalized but will only come into effect over the coming period (e.g., Markets in Financial Instruments Directive II, securities financing transaction reporting, benchmarks regulation, Basel's Fundamental Review of the Trading Book, total loss-absorbing capacity, etc.), and others are still being debated or finalised (Bank Structural Reform, EU Financial Transaction Tax, etc.).

However, it is clear from discussions with our members that the legal, business, and operational challenges resulting from the implementation of these regulatory changes are forcing them to reconsider their activities and even presence in Europe. Consequently, we believe it is important that the Commission's review considers both the impact of regulations that have already been finalized and the cost of steps that companies (financial and not) operating in Europe have already taken to prepare for future and likely regulatory changes (and how those changes impact the counterparties and clients of such companies, as well as their competitiveness and profitability).

Rules affecting the ability of the economy to finance itself and grow

The Bank Structural Reform ("BSR") proposal currently being considered by the co-legislators has the potential, if not carefully thought through and drafted, to damage financial institutions' ability to perform much needed market-making activities to the benefit of capital markets and the economy as a whole. Additionally, we

remain concerned that the Commission's BSR proposal will impact the ability of universal banks to provide risk mitigation products to corporates, reducing their ability to hedge risk.

In the United States, the implementation of the Volcker Rule, in combination with several bank capital rules resulting from Basel III, have led to increased concerns regarding the liquidity of the markets, including equities and fixed income, which have played a contributing factor to recent market instability. The Volcker Rule permits market-making under certain circumstances, recognizing the importance of such activity to the growth and proper functioning of capital markets. The BSR proposal would greatly hamper such market-making, however, which would significantly hurt the European economy given its larger reliance on bank intermediation. Importantly, the European Central Bank ("ECB") also agrees that market-making should be preserved in its current state, as such activity is important in order to "maintain or increase asset and market liquidity, moderate price volatility, and increase security markets' resilience to shocks," which is "essential for financial stability, the implementation and smooth transmission of monetary policy, and the financing of the economy."[1]

On bank capital issues, the Chamber believes that capital and leverage standards that are too onerous can have serious, unintended negative consequences. The impact of the Basel III capital rules, the net stable funding ratio ("NSFR"), the liquidity coverage ratio ("LCR"), and now new standards on total loss-absorbing capacity have harmed capital formation by raising the costs of capital and immobilizing resources that would otherwise been used as productive capital for businesses to grow and operate.

One example we would like to highlight in particular are new rules relating to the Fundamental Review of the Trading Book (the "FRTB") recently released by the Basel Committee on Banking Supervision. These rules revise how the lines are drawn between a bank's "banking book" and "trading book" and will fundamentally change the risk-based capital requirements for banks. The Chamber believes that several of the proposed changes "double count" certain risk for a bank's trading book (particularly through "residual risk add-on" charges), leading to excessive capital

[1] http://www.ecb.europa.eu/ecb/legal/pdf/en_con_2014_83_f_sign.pdf (3.3)

requirements that will greatly impact the health of the global securitization markets. Given that the Commission is seeking to boost securitizations within Europe as part of CMU, we strongly believe that adoption of the FRTB rules will only be counterproductive and hurt the growth of several markets, including the commercial real estate market.

A related concern is the impact of new bank capital rules on lending to small- and medium-sized enterprises ("SMEs"), and whether such rules have discouraged financial institutions from lending to SMEs, thus hurting their potential growth. We believe that this concern is particularly pronounced in Europe where the cost of debt and equity financing remains too high for SMEs to use.

Studies and market participants have noted a net decline in lending to SMEs, particularly as a result of CRD IV and related implementation of several other capital rules, including the NSFR and the LCR. The Chamber believes that this failure is in large part due to the decision not to apply these standards in a systematically proportional way. This is particularly true of CRD IV, which was based off of capital standards for internationally active depository institutions but actually applies to credit institutions of all sizes in Europe. The ECB has noted that these capital changes may, in the short term, incentivize banks to adjust their assets and deleverage, rather than raise new equity, which may have "significant negative effects on lending."[2] A specific way to moderate the negative impact would be to allow banks to discount segregated margin from their derivative exposures. Moreover, in the context of the Commission's desire to create jobs and growth throughout the European Union, we believe that it is particularly important for the Commission to tailor the application of bank capital rules to banks of all sizes, weighing the expected benefit of increased financial stability against impediments to future growth of the economy.

On tax, we take the view that the Financial Transaction Tax currently being negotiated by ten Member States under the enhanced cooperation procedure will greatly hamper the achievement of the CMU's objectives to enlarge and deepen EU capital markets. Even more worryingly, it appears that the ten participating member states are considering a very narrow market making exemption for shares and no

[2] https://www.ecb.europa.eu/pub/pdf/other/impact_of_the_crr_and_crd_iv_on_bank_financing.en.pdf?88c21ee4d8283b0cbd89a25700b32cda, p. 9

market making exemption at all for derivatives, and discussions in the group on how to limit the negative effects of the tax on the real economy and pension funds are still ongoing.

On the securitisation file currently being considered, we believe it is important that the co-legislators ensure appropriate calibration of the Capital Requirements Regulation ("CRR") and Solvency II capital charges for Simple, Transparent, and Standardised ("STS") securitisation.

We would also question the appropriateness of increasing further limits to shadow banking exposures and invite the Commission to fully consider the potential impacts on the financing of the economy in its report on the appropriateness and impact of imposing limits on exposures to shadow banking entities under the CRR.

We take the view that the EBA should reconsider its proposals until existing shadow banking reforms have been implemented and their effects seen. Both the Securities Financing Transactions Regulation ("SFTR") and EMIR have risk mitigation and transparency requirements in this space. Moreover, if these proposals will not be reconsidered, many funds, such as money market funds and loan origination / purchase funds, will set limits to the type of non-bank credit intermediation that the CMU is trying to achieve.

We are also concerned that Solvency II may have a unintended consequence of limiting investment in important infrastructure and other long-term projects, hampering the growth of the European economy. Properly calibrated capital requirements are necessary for ensuring continued growth in these areas. In this respect, we support the Commission's recent decision to work with European Insurance and Occupational Pensions Authority to amend the Solvency II capital requirements and promote investment in infrastructure corporates.

We are very concerned, however, by the Commission's continued focus on certain non-traditional and non-insurance activities ("NTNI") as per the recent consultations set forth by the International Association of Insurance Supervisors ("IAIS"). We believe that many of the product and activity categories highlighted for additional consideration by the IAIS do not pose a systemic risk. For example, the European Systemic Risk Board has recently identified variable annuities as an NTNI

category that should be monitored.[3] The Commission should question whether such products and activities pose a systemic risk to the financial system or the broader economy, or whether the IAIS's analysis is unfairly focused on the potential for default of a particular insurer.

Unnecessary regulatory burdens

We take the view that a proportionate approach should be taken when devising new legislation, to make sure that unnecessary regulatory burdens are not created. Such legislation should take into account the impact of regulatory changes on the regulated institution, its clients and counterparties, and any other parties that would also be associated. Given that many of these market participants operate globally, we believe that policymakers should also consider whether new legislation or regulation is duplicative of regulation that exists in another jurisdiction and whether imposing such duplicative regulation would result in its intended benefit.

For example, we consider that aligning diverging reporting obligations should be a priority for regulators going forward. From an EU-US perspective, reporting requirements for derivatives may vary considerably, and the double-sided reporting required under EMIR appears to be burdensome as well as inconsistent with the US approach of single-sided reporting. We believe that EMIR's current requirement to require intragroup transactions of end-user hedgers to be reported is also unnecessary, as such trades do not increase systemic risk but impose the same types of reporting burden requirements as external derivatives transactions. Moreover, we believe that the current (and possibly unintended) inclusion of private individuals' economic activities, such as sole traders, represents an anomaly. Many private individuals find it practically impossible to comply with rules designed for firms (such as timely confirmation of trades) and do not pose systemic risks in the same way that companies do because their scale and type of activity dramatically differs.

In this respect, we believe that is important for the Commission and United States to agree on a substituted compliance regime for clearing, trading, and margin rules in 2016. We note that substantial progress has been made in this area and hope

[3] *See* Pgs. 14-15, Report on systemic risks in the EU insurance sector, European Systemic Risk Board (Dec. 2015), *available at* https://www.esrb.europa.eu/pub/pdf/other/2015-12-16-esrb_report_systemic_risks_EU_insurance_sector.en.pdf?12bf2624290888cf8635ce0dffa41993.

that the Commission and the United States can continue this dialogue through the upcoming Financial Markets Regulatory Dialogue ("FMRD").

In this connection, the Chamber continues to support the goal of enhancing regulatory cooperation across all sectors, including financial services, through the Transatlantic Trade and Investment Partnership. While financial services regulators should always remain the decision maker regarding regulation, they should also be subject to general process disciplines, such as transparent, participatory and accountable decision making, as well as general obligations to consult with their foreign counterparts and consider the international impact of their decisions. We also believe that working with the B20 and incorporating their recommendations at the G-20 level could help avoid many inconsistencies among regulators.

With respect to broader capital markets issues, we believe that policymakers should carefully assess the treatment of non-financial firms in the framework of MiFID II, in particular on the key issue of the ancillary activity. We take the view that only those non-financial companies trading in commodity derivatives on a material basis and/or in a disproportionate manner, and not those doing so on an ancillary basis, should face the same treatment as financial institutions. Similarly, in the context of EMIR, we believe that ESMA's proposal that the clearing threshold on derivatives by non-financial companies should be set "irrespective of their hedging or non-hedging nature" would be extremely harmful.

In this framework, also taking into account the objective of rendering the business environment less burdensome, we very much welcome the recent Commission's proposal to review the Prospectus Directive. More specifically, a good example of eliminating duplicative, unnecessary requirements, is Article 9 of the proposal, where a frequent issuer admitted to trading on a regulated market can fulfil its obligation under the EU Transparency Directive by integrating financial reports into the Prospectus Regulation's new universal registration document. We also believe that the proposed elimination of prospectus requirements for capital raisings below €500,000 and a proportionate prospectus regime for issuers with market capitalizations of less than €200 million are important steps in the right direction. With respect to similar reforms in the United States, we have urged policymakers and the Securities and Exchange Commission ("SEC") to ensure that investors in such companies continue to benefit from robust investor protection. We recommend that

the Commission do the same and conduct post-implementation reviews of these reforms on a periodic basis.

Finally, it is important to recognize the impact of legislative and regulatory changes on corporate treasurers, both with respect to short-term funding challenges and to risk mitigation activities. In particular, the Chamber remains particularly concerned about the Money Market Fund ("MMF") regulation currently being discussed at European level. The Chamber strongly supports the use of MMFs by treasurers as short-term cash management tools. Corporate, government, and institutional investors use constant net asset value ("CNAV") funds to manage cash holdings on a short-term basis and benefit from the high degree of liquidity, diversification, and stability provided by CNAV funds.

We understand that there are proposals to eliminate the CNAV category of funds in most circumstances, replacing them with Low Volatility Net Asset Value ("LVNAV") funds. We strongly object to the European Parliament's proposed inclusion of a so-called "sunset" clause which would provide for the automatic disappearance of the LVNAV category after a period of five years. We take the view that the inclusion of this provision will discourage investments in LVNAV funds and encourage investors to turn to bank deposits or bespoke, CNAV-like arrangements with banks, both of which would reduce investment in European issuers and result in a significant reduction in yield for current investors in CNAV funds. Banks may also not have the capacity to accept such deposits given the regulatory charges associated with such funds under the LCR.

Interactions of individual rules, inconsistencies and gaps

The increasing use by legislators of regulations rather than directives is positive, in particular as it is likely to eliminate problems related to gold-plating and inconsistent transposition of EU rules in EU Member States. We applaud these decisions and encourage the Commission to recommend the use of a regulation rather than a directive where such action would provide clarity to the markets, eliminate differences in national treatment, and promote financial stability through the consistent application of a regulatory change. Importantly, the recent European Parliament report on stocktaking and challenges of the EU Financial Services by Mr. Balz calls on the Commission to develop a thorough analysis and report of all gold-

plating measures taken by EU Member States in the field of financial legislation and to submit them to Parliament by the end of 2016.

We also support the development of a single rulebook for the single market, with ESMA ensuring coordination and consistent supervision across Member States and leaving national supervisors with the task of enforcing the rules. This is in line with the principle of subsidiarity, although we do believe that there should be a baseline in each Member State for investor protection and encouraging cross-border operations and financing.

However, in a broader sense, the Commission should be cognizant of the cumulative impact of the regulatory changes that have come into effect and seriously consider how those rules interact with upcoming regulations at both the European and international level. In the previous section, we have already discussed the impact of potential MMF reform on corporate treasurers, despite the fact that the law has not yet come into effect. In the United States, we have already seen that upcoming liquidity regulations, including the LCR, force banks to prefer high-quality liquid assets ("HQLA") over other assets, and non-operating deposits from institutional investors tend to have the highest HQLA requirements. Consequently, banks will tend to favor retail deposits, which have much lower HQLA requirements, creating a natural disincentive for deposits from corporate customers that are being diverted as a result of MMF reform. Given these and other bank capital requirements, depository institutions may also be forced to charge for such corporate deposits to the detriment of their corporate depositors.

On market making, ESMA has recently recommended in the framework of the Short-selling regulation ("SSR") that the European Commission streamline the market making definition as part of its upcoming review of the SSR. We believe this would be important as it would allow market makers to better engage in legitimate market making business.

Finally, we take the view that general improved coordination between market and prudential regulators across various jurisdictions is key to reducing inconsistencies and gaps going forward. From an EU-US perspective, the further development and structural improvement of the biannual FMRD would be beneficial. We believe that effective cross border regulation is crucial to integrated global financial markets,

financial stability and sustainable economic growth. The Commission should aim to develop and implement rules reflecting global, outcomes- based frameworks. Without this approach, market participants and end users will have limited access to the global financial markets and the broad range of products they offer to address risk management needs.

Rules giving rise to possible other unintended consequences

The Chamber has consistently called for post-implementation reviews of legislative and regulatory changes to financial services regulation given how interlinked such regulation is to the financing the broader economy and for promoting access to credit for a range of actors. We applaud the Commission for its proactive steps to address these issues through this Call for Evidence, as well as through its reviews of CRD IV and EMIR. In addition to post-implementation reviews, however, it is important to address anticipated impacts on the real economy from proposed legislative and regulatory changes before they become law. Addressing these issues proactively helps narrow the potential unintended consequences from such changes and minimizes the harmful impact on regulated entities and the broader economy.

In this regard, we would like to draw your attention to the securitisation rules currently being negotiated, and in particular on the Council General Approach adopted late last year. The Council text foresees limiting STS securitization label only to products involving entities established in the EU. We take the view that this approach will fragment the securitisation market even further and risks limiting the growth potential of the European securitisation market itself. European investors should be encouraged to diversify their investments across economically similar products, regardless of where the underlying loans may have been originated.

Another example worth mentioning refers to the benchmarks file recently agreed upon by the co-legislators. In that context, the co-legislators reached a compromise on the third country regime, allowing the use of third country indices in the European Union, through "recognition" or "endorsement" regimes, based on compliance with the IOSCO Principles on Benchmarks. However, taking into account that other major jurisdictions, including the U.S., do not foresee the adoption of legislation on benchmarks any time soon, the practical implications of the new EU legislation are yet to be determined. There is a risk that the lack of sufficient clarity

leads to conflicting interpretations that disrupt the market, in particular in the context of the functioning of the "recognition" or "endorsement" regimes. While we welcome the helpful reference to the IOSCO Principles being a basis for the "recognition" regime for third country benchmarks, we take the view that a stringent interpretation of the requirement that compliance with the IOSCO Principles must be "equivalent to compliance with the requirements established under the (EU) Regulation" may—in the worst case scenario—effectively void this potentially positive development. It is thus important to be vigilant on the possible unintended consequences of the European legislation and on the global level playing field.

We also welcome the recommendations included in the European Parliament report of Mr. Balz, which is also mentioned in the call for evidence. In particular, we support calls to conduct regular (at least annual) coherence and consistency checks, also on a cross-sectoral basis and on every draft legislative act; to conduct regular (at least annual) proportionality and effectiveness checks, particularly with regard to the requirements applicable for small and medium sized market participants and on every draft legislative act; and for the Commission services, in cooperation with the ESAs, SSM, and ESRB, to conduct a comprehensive quantitative and qualitative assessment every five years of the cumulative impact of the EU financial services regulation at the EU and Member State level. It is positive that the Commission's Call for Evidence represents an initial "answer" to the European Parliament's demands.

Conclusion

Thank you for your consideration of these views. The Chamber strongly supports the Commission's Call for Evidence as a key element of the overall plan to implement the CMU in Europe and take appropriate stock of the cumulative impact of financial services regulation on jobs and growth in the European economy. We look forward to an ongoing dialogue with you on these issues.