EUROPEAN CENTRAL BANK

EUROSYSTEM

Eurosystem contribution to the European Commission’s call for evidence on the EU regulatory framework for financial services

General remarks

The financial crisis has led to a much-needed and far-reaching reform of the European (and international) regulatory framework and a redesign of its supervisory architecture. While a number of key items of the post-crisis agenda are yet to be fully implemented, reforms have already had tangible effects, notably making the banking sector more resilient through higher and better-quality capital requirements and bringing about improved funding profiles for banks. Reforms were also necessary to induce a fundamental reassessment of the risks associated with certain types of products and an improvement of banks’ risk management practices and governance. Derivatives markets and market infrastructures are also being made safer through a comprehensive reform agenda, which has the objectives of improving transparency, mitigating systemic risk and protecting against market abuse. There has been progress in addressing critical fault lines revealed by the crisis, notably additional requirements for those financial institutions which have a systemic relevance, as well as a reformed institutional architecture with centralised supervision, recovery and resolution of banks at the European level. The rules in place to ensure financial stability are essential for the functioning and the safety of the system and to restore investors' trust in financial services.

The regulatory framework for banks is largely in place, but a few important initiatives on the regulatory agenda for banks and the non-bank sector still need to be finished. Key elements of the post-crisis regulatory agenda, such as the leverage ratio (LR), the revisions to the standardised approach for credit risk and a reduction in the excessive variability in risk-weighted assets (RWA), need to be finalised and implemented in Europe in order to complete the post-crisis framework for banks. All these elements are expected to be finalised by end-2016 at the international level. In addition, other measures which have been agreed on at the international level still need to be incorporated in the European framework the net stable funding ratio (NSFR), the total loss absorbing capacity (TLAC) for global systemically important banks (G-SIBs), and the fundamental review of the trading book (FRTB). This is expected to contribute significantly towards reducing regulatory uncertainty, which the industry considers to be a key element to unlocking funding and avoiding a further postponement of investment decisions. Nevertheless, further efforts at the international and European levels are warranted in order to tackle possible risks emanating from the non-bank sector, notably finalising the work plan on central counterparty (CCP) resilience, recovery and resolution and developing the macroprudential toolkit for non-banks.

Initiatives to support the financing of the economy should maintain the robustness of the regulatory framework resulting from post-crisis reforms. In the current scenario characterised by a lack of investment and therefore a lack of growth and employment across the euro area, several initiatives have been launched recently with the aim of supporting SMEs' and banks' abilities to contribute to the financing of the economy. These are welcome for their potential to support growth. However, it should be noted that financial stability is an important condition for ensuring growth. In particular, only strong and well-capitalised banks are able to effectively finance the economy and support SMEs over the financial cycle. While an assessment of the various regulatory measures introduced since the crisis is needed to ensure that new legislation is achieving its intended objectives, the risks of a possible wave of deregulation, like the one which led to the financial crisis, should be kept in mind.

Reaping long-term benefits implies both assuming temporary costs that emerge in the transition period and complementing regulation with measures to correct any unintended long-term impacts that are identified. As noted in the European Central Bank's (ECB's) report entitled "The impact of the CRR and CRD IV on bank financing",[1] it is important when analysing costs to distinguish between the transition and steady-state impacts of financial services regulation. This is even more the case as market or supervisory pressure to frontload the phase-in arrangements may pose or have posed challenges for certain institutions in meeting the requirements well ahead of the planned phase-in stage. Consequently, caution should be exercised in drawing conclusions from the transitional stage and early years of implementation, not just because industry costs are likely to reduce over time, but also because the benefits of changes to the regulatory framework are likely to increase over time.

Ultimately, it is of the utmost importance to ensure that regulations are able to preserve financial stability, while leaving sufficient room for markets to develop and fully play their role in the economy. The financial system has already changed and improved in key aspects, thanks to the new regulatory framework and the industry's and supervisors' efforts to make it more resilient. This will continue as the reforms take effect. As implementation is under way, there is a need for ongoing monitoring in order to assess the effectiveness and market impacts of the reforms and to identify inefficiencies or new risks and vulnerabilities that may require policy action. With regard to the proportionality of these regulatory requirements, using the size of institutions alone might be insufficient to justify less demanding standards. A proportional approach should take into account other important characteristics, such as the riskiness of an institution and should be supported by sound evidence specific to each type of requirement. While it may be too early to assess the cumulative impact of reforms – as some reforms are still

---

[1] European Central Bank, (2015), The impact of the CRR and CRD IV on bank financing – Eurosystem response to the DG FISMA consultation paper, December. (Link)

ongoing and as long-term beneficial effects may not yet be tangible – such continuous assessment will be necessary to appreciate the progress achieved and to ensure that markets are able to fully play their role in the financing of the economy. Therefore, where unintended impacts are identified and unjustified barriers are hampering the proper functioning of markets as a result of the recent proliferation of financial regulation, corrective measures should be envisaged while maintaining the aim of financial stability. It is from this perspective that the assessment of the new regulatory framework should take place.

The European exercise should also take into account ongoing initiatives at the international level. One example is the Financial Stability Board's (FSB's) first annual report to the G20, published in November 2015, on the implementation and effects of the G20 financial regulatory reforms.[2] The report concludes that the implementation of reforms has been steady but uneven, with most progress achieved in the banking sector, while work still needs to be undertaken to transform shadow banking into resilient market-based finance. It also highlights that reforms have made the global banking sector more resilient, while maintaining the overall provision of credit to the real economy and without having major unintended consequences. Finally, the FSB recognises that the effectiveness of reforms can only be fully assessed over a period of time that includes a full financial cycle and both normal and stressed market conditions. This annual exercise will contribute to a better assessment and understanding of the implementation of the regulatory framework and its impact.

The Eurosystem contribution seeks to provide evidence from recent impact studies of the effect of the new regulatory framework and to highlight areas where possible improvements could be made. The following provides more details on the specific sections of the call for evidence, namely on: (A) **rules affecting the ability of the economy to finance itself and to grow**, where it is argued that the new regulatory framework (parts of which still need to be implemented) will have net positive effects on financial stability and growth which will prevail in the long term, while some costs may occur in the short term as market participants adjust to the new requirements; (B) **unnecessary regulatory burdens**, such as the lack of standardisation of information and the possible duplication of reporting requirements that should be taken into account – the ECB/Eurosystem is undertaking several initiatives in this regard; (C) **interactions of individual rules, as well as inconsistencies and gaps in the existing regulations** that need to be dealt with, although it may be too early to undertake a thorough assessment of the cumulative impact of interaction between the new rules; (D) **rules giving rise to unintended consequences**, such as an increase in activities outside the regulated framework, which need to be matched with an appropriate toolbox for macroprudential supervisors.

---

[2] Financial Stability Board (2015), Implementation and effects of the G20 financial regulatory reforms, November. (Link)

Specific remarks

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

A.1 Enhanced capital requirements for banks will have net positive effects which will prevail in the long term while adverse loan supply effects are expected to be concentrated in the transition phase as banks adjust to the new requirement.

The Capital Requirements Regulation and Directive (CRR/CRD IV) led to a strengthening of the resilience of the EU banking sector,[3] restoring market confidence and providing a level playing field for the banking industry. Evidence clearly indicates that a substantial capital increase above previous levels was necessary and desirable.[4] In particular, strong capital requirements can have significant long-run welfare gains and can support the role that a healthy and resilient banking system is able to play in facilitating growth over the whole financial cycle. In addition, the CRR, which is directly applicable to all EU banks and competent authorities, is an important step towards creating a more level playing field and achieving closer integration in the EU banking sector.

The short-term cost of higher capital requirements should be measured against the long-term benefits from a financial stability perspective. Empirical work carried out by the ECB[5] to assess the impact of higher bank capital requirements on the euro area economy identifies some adverse impacts on loan supply, though this appears to be relatively limited, mainly affecting lending conditions and economic growth.[6] While these costs can affect the economy mainly in the short run, the benefits of the requirements rise as banks become more resilient on account of the lower probability of default.[7] In analysing costs emanating from the regulatory framework, it is therefore important to distinguish between the transition and steady-state impacts of the requirements.

---

3 European Central Bank (2015), Report on financial structures, October (Link). The regulatory capital ratios of euro area banks continued to improve in 2014 (the median Tier 1 ratio increased to 14.4% in 2014 from 13.0% in 2013). This resulted in an increase in solvency and in leverage ratios.

4 See, for example, Bank for International Settlements (2010), An assessment of the long-term economic impact of stronger capital and liquidity requirements, August (Link). The quantitative cost-benefit analysis conducted by the BIS found that the net benefits from increasing capital ratios remained positive for a broad range of values. Overall, the study concluded that capital ratios were too low and that there was considerable scope to increase capital while also having positive net benefits.

5 European Central Bank (2015), The impact of the CRR and CRD IV on bank financing – Eurosystem response to the DG FISMA consultation paper, December. (Link)

6 This finding holds true both at the country level and the euro area level for different portfolio segments. The impact of the CRR/CRD IV was stronger for less capitalised banks, for banks with lower average risk weights, and for banks with higher non-performing loan ratios. The moderate impact of higher capital requirements on lending rates and GDP was also confirmed by a suite of Dynamic Stochastic General Equilibrium (DSGE) models that was used to calculate the steady-state impact on euro area aggregate GDP.

7 Various studies find that even a moderate increase in the requirement for risk-weighted assets from 8 to 9% would decrease the probability of default of banks from 2.00 to 0.75% and the probability of a banking crisis from 3.0 to 1.9%. See, for example. Bank for International Settlements (2010), op. cit. (Link), and Clerc, L., Derviz, A., Mendicino, C., Moyen, S., Nikolov, K., Stracca, L., Suarez, J. and Vardoulakis, A.P. (2015) "Capital Regulation in a Macroeconomic Model with Three Layers of Default", ECB Working Paper Series No 1827 (Link), Vol. 11(3), pp. 9-63, July.

A.2 Evidence from international and EU studies also demonstrate a positive or neutral impact of financial regulation on GDP growth.

The FSB finds that the improvement in the resilience of the banking sector has been achieved while maintaining the overall provision of credit to the real economy. Overall, the FSB shows that banks have met the higher capital requirements without cutting back sharply on lending.[8] Moreover, the cost of financing to the real economy, whether by banks or bond markets, has remained low in recent years. The extended phase-in period of the reforms coupled with exceptionally accommodative monetary policies and jurisdiction-specific factors may have contributed to this outcome.

Assessments of the macroeconomic impact of the recent wave of financial regulation offer evidence that the expected costs of the reforms will be compensated for by wider economic and social benefits. The regular quantitative impact assessments undertaken by the Basel Committee on Banking Supervision (BCBS) show that most reporting banks have made significant progress towards meeting the new regulatory requirements for capital and liquidity, while the new requirements are expected to have a limited impact on GDP growth.[9] The European Commission has published a comprehensive study that aims to estimate the joint economic impact of many regulatory initiatives.[10] This study comes to the conclusion that the expected costs of the reforms will be compensated for by the wider economic and social benefits. Based on simulations by the Commission, higher bank capital requirements combined with the bail-in and resolution fund are estimated to deliver macroeconomic benefits of around 0.6-1.1% of EU GDP per year (or about EUR 75 billion-140 billion per year, based on EU GDP in 2013). In comparison, the macroeconomic costs of the same banking reforms have been estimated in a separate model and show a long-term negative output effect of about 0.3% of EU GDP per year. Moreover, specific assessments have been made with regard to the macroeconomic impact of stronger capital and liquidity requirements and OTC derivative reforms, which also find a net positive impact of these reforms.[11] Finally, the European Banking Authority (EBA) and the European Commission have assessed the macroeconomic impact of the regulatory reform for insurance companies and broadened the assessment with regard to the liquidity coverage ratio

---

8 Financial Stability Board (2015), op. cit.

9 Bank for International Settlements (2010), op. cit. (Link) The Report concluded that a 1 percentage point increase in the target ratio of tangible common equity (TCE) to risk-weighted assets would lead to a maximum decline in the level of GDP of about 0.19% from the baseline path, which would occur four and a half years after the start of implementation (equivalent to a reduction in the annual growth rate of 0.04 percentage points over this period), followed by a gradual recovery of growth towards the baseline.

10 European Commission (2014), Economic Review of the Financial Regulation Agenda, May.

11 Bank for International Settlements (2013), Macroeconomic impact assessment of OTC derivatives regulatory reforms, August (Link). The study estimates that the macroeconomic costs of OTC derivatives regulatory reforms would range between 0.03% and 0.07% of annual global GDP. The estimated gross benefits from OTC derivatives reforms are 0.16% of annual global GDP, exceeding the costs more than twofold.

(LCR) and currently with regard to the NSFR.[12] Overall, evidence available from these studies demonstrates a positive or neutral impact on GDP growth.

It remains a fact, however, that the weakness of the recovery and of investment in the United States and the euro area since the financial crisis of 2008-2009, as well as the slowdown in global growth and global trade, remain of concern. Concentrating on the needs of small and innovative businesses and projects, and ensuring that they are fairly valued by rating agencies and more generally by markets may be relevant in finding ways to mitigate any undesired impacts of regulatory changes.

A.3 Recent regulatory initiatives such as TLAC requirements and the LR may have short-term costs, but their overall impact on the economy is expected to be positive. These measures should be finalised and incorporated into the European regulatory framework as soon as possible.

The TLAC requirements will significantly reduce the negative externalities of a failure of systemically important institutions that are imposed on the real economy, and they will therefore have an overall positive effect on growth. The standard for minimum TLAC amounts is a crucial leap forward in reducing the systemic risk that global systemically important banks may pose to financial stability and taxpayers.[13] Overall, the FSB impact assessment studies found that the microeconomic and macroeconomic costs of the TLAC requirements are relatively contained and are significantly lower than the total estimated benefits. It is expected that the overall annual benefits in terms of GDP will range from between 45 and 60 basis points.

The finalisation of the LR framework can also bring about substantial benefits. Excessive leverage was undoubtedly one of the root causes of the financial crisis. The largest banks in Europe had built up significant leverage before the financial crisis as their median leverage had risen to around 33 times the level of common equity, with some banks even operating at a leverage of 50 times the level of common equity.[14] Hence, a comprehensive and well-calibrated LR that works as a backstop requirement or as a complement to the risk-based capital framework is an important tool for addressing risks arising from excessive leverage. Thus, the ECB strongly supports the migration of the LR to a Pillar 1 requirement, as foreseen by the Basel Committee. Analytical work at the ECB shows that the LR as a Pillar 1

[12] See DG ECFIN (2007), Impact Assessment: Possible macroeconomic and financial effects of Solvency II, March (Link); and European Banking Authority (2014), Second report on impact assessment for liquidity measures under Article 509(1) of the CRR, December (Link). The study finds that adjustments by individual banks to meet the LCR requirements could lead to temporary supply constraints by those banks. However, the econometric analysis of bank lending trends suggests that these constraints are small or that any excess demand has been picked up by other banks in the industry.

[13] Financial Stability Board/Bank for International Settlements (2015), Assessing the economic costs and benefits of TLAC implementation, November. (Link)

[14] See European Systemic Risk Board (2014), “Is Europe Overbanked?” *Reports of the Advisory Scientific Committee*, No 4, June. (Link)

requirement would lead to a significant decline in the distress probability of highly leveraged banks.[15] A possible extension of the toolkit[16] should be considered.[17]

To reap the benefits of financial reforms, the regulatory agenda needs to be finalised quickly. In addition to the implementation of the TLAC requirements, finalising the regulatory agenda should include the net stable funding ratio, the fundamental review of the trading book and ongoing BCBS work on the reduction of RWA variability (increasing the risk-sensitivity of the standardised approaches for credit and operational risk, work on input floors and other parameters of the IRB approach, and work on output floors).The implementation of outstanding measures will significantly contribute towards reducing regulatory uncertainty, which is a key element in unlocking funding and avoiding a further postponement of investment decisions.

A.4 Simple, transparent and standardised (STS) securitisations facilitate the transfer of credit risk and can be an important source of funding for the real economy, improving the overall resilience of the financial system.

The ECB welcomes the European Commission's legislative package on securitisations, although in relation to securitisations for insurers, we consider that the framework could benefit from increased risk sensitivity in a number of areas. The Commission's September 2015 legislative package on securitisation introduces an EU-wide securitisations framework, including a framework for STS securitisations – for which concrete criteria still need to be finalised – and proposes lower capital charges for banks investing in STS securitisations.[18] These proposals are welcome and should facilitate the revival of the European securitisation markets by encouraging banks' continued involvement in the market, both as originators and investors. Nevertheless, the market revival crucially depends on a broadened investor base, which should involve the continued participation of insurance companies, and on SMEs' access to finance. As expressed in the joint Bank of England-ECB response to the Commission's consultation on an EU framework for simple, transparent and standardised securitisation,[19] the Solvency II framework could be further enhanced so that capital charges for insurers better reflect the features of STS securitisations and thus possibly become a more attractive investment option for insurers.[20]

---

15 See *European Central Bank (2015), "The impact of the Basel III leverage ratio on risk-taking and bank stability", Financial Stability Review,* November, pp. 121-133. (Link)

16 See also the comments on the macroprudential framework in the ECB's Opinion (CON/2012/5) on the proposals for the CRR and CRD IV, p.6. (Link)

17 See European Systemic Risk Board (2015), The ESRB Handbook on Operationalising Macroprudential Policy in the Banking Sector. Addendum: Macroprudential Leverage Ratios, June. (Link)

18 Both proposals are available on the European Commission's securitisation webpage. (Link)

19 Bank of England and the European Central Bank (2015), Joint response to the Consultation Document of the European Commission: "An EU framework for simple, transparent and standardised securitisation", March. (Link)

20 The ECB is preparing an Opinion on the Commission's proposal.

A.5 Analysis finds mixed evidence for market liquidity in current bond markets in the euro area. In sum, the relevance of regulation for the decline in market liquidity is not clear, but the financial stability benefits of post-crisis regulations are perceived overall to outweigh the potential costs to market liquidity.

Mixed evidence is found regarding current liquidity. Quantitative price-based indicators do not show a clear picture of deteriorating bond market liquidity as the bid-ask spreads have remained tight. By contrast, volume-based indicators are consistent with the fact that secondary market liquidity appears low compared with the pre-crisis era and that turnover ratios showed a steady decline across most market segments while deal sizes have generally shrunk.

From a financial stability perspective, recent corrections have shown that market liquidity might be less resilient during periods of stress and that it depends on the ability and willingness of market-makers to respond to temporary imbalances, which appear weakened. The reduction in market-making is supported by empirical evidence on the inventory holdings of market-makers which has declined since the financial crisis.[21] Moreover, as trade volumes have declined, the relevance of prices as an adjustment mechanism for market-makers has declined. Experience in the context of the Eurosystem purchase programmes suggests a significant loss of reliability of indicative prices that are provided by dealers and generally used to construct bid-ask spreads, in contrast with executable prices, which are not recorded since the OTC structure of bond markets still prevails. At the same time, it is acknowledged that the market liquidity observed before the financial crisis was partly due to an inadequate pricing of liquidity risk paired with an illusion of liquidity. One of the intended objectives of regulation is to address this form of inadequate risk management, and thus an impact on market liquidity should be expected. However, it is unlikely that regulation alone can explain the change in market liquidity.

From a market microstructure perspective, trading is changing across several dimensions. First, there is a common trend for the use of electronic trading. Second, participation in markets is shifting to new kinds of market-makers, including high-frequency trading. Third, we have also witnessed an increasing number of new platforms, including less transparent trading venues.[22] Finally, trading strategies are evolving and some more pro-cyclical trading strategies are gaining prominence.[23] For these reasons, market depth may not be as deep as it may appear.

In sum, the relevance of regulation for the decline in market liquidity is not clear. The ample market liquidity observed before the crisis certainly does not provide a benchmark for the future. The crisis demonstrated that the level of liquidity was clearly unsustainable and, in fact, was associated with some of the most illiquid

---

21 See Committee on the Global Financial System (2014), Market-making and proprietary trading: industry trends, drivers and policy implications, CGFS Papers, No 52. (Link)

22 See European Central Bank (2015), Financial Stability Review, November, Box 4, p. 59. (Link)

23 See Bank of England (2015), Dealing with change: Liquidity in evolving market structures, speech by Minouche Shafik, 27 October. (Link)

market conditions since at least the Great Depression.[24] Therefore, the financial stability benefits of post-crisis regulations (safer banks) are perceived, overall, to outweigh any potential costs to market liquidity. In fact, lower market liquidity may reflect a more adequate pricing of liquidity risk, thus removing the liquidity illusion that was present in markets before the financial crisis.

B Unnecessary regulatory burdens

B.1 Although the reform agenda has included additional reporting and disclosure requirements, thereby increasing transparency and market discipline, there may be scope to further streamline requirements to avoid unnecessary duplication and ensure their proportionate application.

New regulation has increased transparency but has imposed a new set of reporting requirements for financial entities, thereby raising compliance costs, costs, in particular for smaller institutions which are more sensitive to this administrative burden. While additional reporting requirements have increased transparency and enhanced the availability of information available to investors and supervisors, this should be done in a way that minimises the risk of disproportionately increasing compliance costs. To that aim, ensuring full coordination in the establishment of different reporting requirements such that the information is eventually reported only once and used for several purposes becomes of the essence, where it is in line with the legal basis and the rules on data protection. Compliance costs could also be significantly reduced by simpler and automated calculations, in particular for proportionality and exemptions thresholds.

To take into account the different capacities of institutions to comply with all reporting requirements – due to the significant resources necessary to monitor regulatory changes and achieve compliance processes – a proportionate application of these requirements should be pursued. Proportionality must indeed guide our action in the reporting area if we want to be consistent with the objective of preserving diversity of business models within the EU while ensuring also a risk-based prudential supervision. Various options could allow for more proportionality, such as introducing a phase-in for new reporting requirements, based on the institution's size and riskiness and other relevant factors, or providing for possibilities of less frequent, less granular or simpler reporting.

Another area where streamlining and efficiency could be improved relates to the process for adopting or revising reporting requirements that apply at the European level. The time of approval and validation of the Implementing Technical Standards (ITS) on supervisory reporting does not always appear compatible with the monitoring of prudential requirements and with supervisory needs. There is a clear need for ease and for a shorter process in this respect.

---

[24] See Federal Reserve Bank of New York (2015), Regulation and Liquidity Provision, speech by William C. Dudley, 30 September. (Link)

Enhanced coordination between the regulators is needed to limit reporting burdens and to ensure the efficient collection of information. Coordination can avoid possible inconsistencies, incoherence, overlaps and gaps in the regulations, as well as alleviate restrictions on data access. It can also ensure that the data collected meets the needs of more than one stakeholder. For example, the data provided by trade repositories to authorities as required under the European Market Infrastructure Regulation (EMIR) are non-standardised and raise issues in terms of quality, which in turn represent a significant impediment to the use of the data by ESCB members.

Key international initiatives are ongoing and aim at improving the information frameworks on which key policy decisions are based. This international work is led by the Data Gaps Initiative (DGI) which supports several G20 projects, such as bilateral and multilateral surveillance and initiatives focusing on global systemically important financial institutions. It aims to encourage the exchange of data and metadata among G-SIB home supervisors and institutions responsible for financial stability in these jurisdictions. To a certain extent, international financial institutions will also have access to aggregated data in order to improve the quality of their databases, and they will be made available for policy use. As a member of the Inter-Agency Group on Economic and Financial Statistics (IAG)[25], the ECB has been deeply involved in the development and implementation of these recommendations and strongly supports the second phase of this initiative (DGI-2), which was recently approved by the G20.

B.2 Standardising information (unique identifiers for institutions, products and transactions) is vital in order to avoid unnecessary regulatory burdens.

There is a high risk that new barriers to integration may emerge without EU-wide and global approaches to integrated data standards. Following the agreement by G20 leaders in 2009 that all OTC derivatives contracts should be reported to trade repositories (TRs), the FSB requested a study of the feasibility of various options for producing and sharing global aggregated data,[26] and also engaged the Committee on Payments and Market Infrastructures (CPMI) and Board of the International Organization of Securities Commissions (IOSCO) in the work.[27] On account of the importance and also the effort involved in establishing global standards, EU-wide and global data standards should be established in a coordinated way, as has happened with the globally coordinated work on OTC

[25] The Inter-Agency Group on Economic and Financial Statistics comprises the Bank for International Settlements (BIS), the ECB, Eurostat, the International Monetary Fund (IMF, Chair), the Organisation for Economic Co-operation and Development (OECD), the United Nations (UN) and the World Bank. It was established in 2008 to coordinate statistical issues and data gaps highlighted by the global crisis and to strengthen data collection.

[26] Financial Stability Board (2014), Feasibility study on approaches to aggregate OTC derivatives data, September. (Link)

[27] Bank for International Settlements/International Organization of Securities Commissions (2015), Consultative report – Harmonisation of the Unique Transaction Identifier, August. (Link)

derivatives reporting, in order to develop global guidance on data harmonisation relating to OTC derivatives.

The need for initiatives in data standardisation and harmonisation are also reinforced by calls from the financial industry. For instance, in a recent letter to various authorities and in the context of reporting the OTC derivatives data to TRs, eleven trade associations wrote that “poor data quality reduces the value of the data for regulators and limits their ability to fulfil their regulatory tasks. Lack of standardization and differences in requirements across jurisdictions increase the risk of misinterpretation and the cost for reporting parties that have reporting obligations in multiple jurisdictions.”[28]

Data standardisation across the global financial market – spanning jurisdictions, regulations, instruments and market segments – is urgently needed. The FSB’s work on the development of global guidance to harmonise key OTC derivatives data elements, including Unique Transaction Identifiers (UTIs)[29] and Unique Product Identifiers (UPIs), is a positive development. This important initiative is limited to the derivatives market and should be extended to other segments of the financial markets, such as the money market.

In particular, the three core identifiers determining the counterparty, trade and instrument traded need to be commonly agreed and used. A global standard for counterparties, the Legal Entity Identifier, is already in place, but its use needs to become widespread and compulsory. The International Securities Identification Number (ISIN) to identify securities also exists, but its use is not global or compulsory.

Establishing a common standard for TRs and an operational framework for making the data available to the relevant authorities is a route worth exploring. This would enable the authorities to overcome problems with data fragmentation and duplication (two or more reports on the same transaction provided by counterparties or intermediaries), and would provide a consolidated view of the OTC derivatives market, which is necessary for the collection and comprehensive analysis of OTC derivatives data from multiple TRs.

The development and/or extension of the use of these identifiers will help reduce the burden of reporting agents as commonly used identifiers facilitate the introduction of uniform reporting requirements across jurisdictions. In several cases, they also reduce the amount of information actually reported as it is possible to obtain such information from other sources by using the unique identifier as the link. For instance, in the case of Securities Holdings Statistics (SHS), the ECB/ESCB reporting requirements for holdings of securities identifiable by ISIN codes are limited to information on “who holds” and “how much” of “which ISIN”, while the reference information on the security held (e.g. issuer, maturity, price) is not reported by reporting agents but taken from the Centralised Securities Database

28 Letter to several authorities from eleven associations entitled “Key Principles to Improve Global Trade Reporting and Data Harmonization”. (Link)

29 The role of the UTI is to uniquely identify each OTC derivatives transaction that, at the authorities’ request, is to be reported to a TR.

(CSDB). The link between the CSDB and SHS data is possible due to the unique identification of a security through ISINs. But not all holdings of securities can be compiled in this way, as some securities do not have an ISIN.[30]

A further example of standardisation is the ECB's money market statistical reporting (MMSR) which will go live in the second quarter of 2016 and for which all the reporting will be based on the ISO 20022 standard. This will help ensure high data quality and will apply for the whole euro area, although the Bank of England has also publicly expressed its willingness to use the same standard for its reporting.[31]

B.3 The ECB is undertaking several initiatives to standardise data reporting and thereby reduce unnecessary burdens.

The European Reporting Framework (ERF)[32] which is a strategic, long-term project could serve as an example to alleviate unnecessary regulatory burdens stemming from the new regulatory framework. The idea behind the ERF is to collect all the data required for different statistical purposes (in a first stage) and for banking supervision (in a second stage) using an integrated and harmonised cross-country approach. For the time being, the project is in its early stages and many aspects, including the timeline, are still work in progress. Furthermore a legal framework that is compatible with higher-ranking rules of law, including the rules on data protection, has to be established.

The Banks' Integrated Reporting Dictionary aims at creating a common language with industry. The Banks' Integrated Reporting Dictionary (BIRD) initiative launched by the ECB consists of documentation (i.e. it is not an IT tool) aimed at providing a standardised model for organising banks' internal data warehouses in an integrated way, and for the transformation of that data into the reports that the banks transmit. The application of the BIRD by the banks is strictly voluntary and it is expected to deliver more efficient and, in the longer run, less costly report production, thanks to higher consistency and harmonisation of the data, as well as the univocal interpretation and clarity of regulations.

In parallel, the ECB is producing a Single Data Dictionary. The Single Data Dictionary will describe all the information collected by the ECB through the various reporting frameworks with the aim of producing clear, non-overlapping data definitions, with reconciled meanings across all regulatory frameworks, which will be made available to all national central banks and national competent authorities.

The AnaCredit initiative currently being developed by the ESCB is expected to collect granular information on credit and credit risk exposures as of early

30 For more information on SHS, see European Central Bank (2015), "Who holds what", *Economic Bulletin*, February. (Link)

31 Bank of England (2015), Sterling Money Market Data Collection – Reporting Instructions, December. (Link)

32 European Central Bank (2015), European Reporting Framework (ERF): Key facts and information, June. (Link)

2018. It will be based on harmonised concepts and definitions and will provide complete coverage for (at least) all euro area countries, thereby ensuring more usability of the data for multiple purposes and comparability than is currently the case. This is another positive example of the standardisation of data reporting across the euro area which will lead over time to decreased ad hoc requests (e.g. via surveys) and stabilise the reporting requirements, after the initial phase-in of the endeavour. For highly automated applications, stability is a key factor in minimising costs. The ECB is well aware that the foreseen benefits will all necessarily come with relatively high set-up costs, especially for banks in countries where no such granular reporting of credit is currently in place. However, these costs should be seen in relation to the expected benefits which will appear over the medium term, both from a central banking perspective and for the markets themselves. The ECB has sought at every stage of drafting the draft ECB regulation on AnaCredit to keep the costs as low as possible, which has included carrying out a strict cost-benefit analysis to minimise the reporting burden and take into account the information provided by potential reporting agents. Therefore, the draft regulation in its current version establishes only the scope of Stage 1. To ensure proportionality, the draft regulation foresees that smaller institutions can be granted derogations by the respective national central bank.

C Interactions of individual rules, inconsistencies and gaps

C.1 Assessing the cumulative impact of recent legislation is welcome and necessary to avoid any unintended consequences of the new regulatory framework, although it may be too early to draw final conclusions from such an assessment.

It may be too early to assess the combined effect of post-crisis reforms as some key measures still need to be implemented. Since most reforms are still in the process of implementation, longer-term effects in terms of the reduced frequency and severity of financial crises may not yet be fully apparent. In combination, the reforms will pursue objectives which themselves interact and should lead to a well-functioning financial system. For example, measures which target information asymmetries (e.g. transparency and disclosure requirements) or which align private incentives with public interests (e.g. measures addressing the too-big-to fail problem) contribute to both financial stability and efficiency. Whether the reforms are truly effective can only be assessed over a longer period of time that includes a full financial cycle and both stressed and normal market conditions.

Disentangling the impact of financial regulation from the current economic situation (including the impact of low growth, accommodating monetary policy and measures aimed at supporting monetary transmission via the bank lending channel) will be difficult. Any interpretation of the results should therefore be made with caution. In addition, the immediate pre-crisis period was characterised by severe distortions of the financial market and a misallocation of funding. This period cannot therefore serve as a relevant point of reference for judging the effects of reforms.

Nevertheless, there is scope for innovation in how regulators approach the admittedly complicated problem of ensuring consistency. For example, it may be important to establish specialised "regulatory consistency" groups consisting of staff from EU institutions which could each contribute their respective expertise in financial instruments, counterparties and markets to ensure that gaps, loopholes, and inconsistencies are minimised.[33] Such groups could be tasked with reviewing the consistency of regulation from different thematic perspectives, for example looking at the consistency of investment guidelines, capital requirements and restrictions for various financial market participants (such as banks, insurers, pension funds, mutual funds, hedge funds, proprietary trading firms, etc.) given the various investment drivers for each participant (short-term trading, hold to maturity, etc.). The purpose would not be to initiate any changes to regulation, but purely to make factual assessments of inconsistencies, using a small composition of dedicated staff from EU-level stakeholders such as the EBA, the ECB, the European Securities and Markets Authority, the European Insurance and Occupational Pensions Authority, the European Systemic Risk Board and the European Commission. These small groups would regularly interact with one another and report their findings to designated EU entities, such as the European Commission and the Joint Committee of the European Supervisory Authorities. If necessary, these groups could of course consult national authorities for their views or for their expertise.

C.2 A number of loopholes and inconsistencies in the current legislative framework remain.

The following sections put forward a number of possible gaps or loopholes in the existing legislation, without being exhaustive.

C.2.1 Examples of gaps in the banking regulation

National implementation of mandatory provisions resulting from a differentiated application of options and national discretions (ONDs) and diverging implementation of directive articles within the European Union can lead to fragmentation or an uneven playing field. The banking prudential framework, also where it is directly applicable through the CRR, is heavily affected by ONDs which grant Member States or competent authorities, or both, the possibility of choosing whether and how to apply different prudential treatments to

[33] An example in this area is the dedicated Task Force established by the Joint Committee of the European Supervisory Authorities, whose work was published on 12 May 2015, on identifying inconsistencies and possibilities for further harmonisation in the disclosure arrangements of asset-backed securities and associated due diligence requirements. Similar dedicated specialised groups could be established under the aegis of the Joint Committee.**Error! Hyperlink reference not valid.**

banks. While some ONDs might be justified in order to take into account national specifics and risks, a differentiated application of ONDs undermines the level playing field and has material effects on the overall level of prudence and comparability. Some of these ONDs, i.e. those granted to competent authorities, can be harmonised via supervisory actions. In this regard, the ECB is working on dedicated projects focused on adopting a common policy in the Single Supervisory Mechanism (SSM).[34] However, the intervention of the EU legislator will be needed in order to achieve broader harmonisation, also with regard to the diverging implementation of important articles of the CRD IV, as well as the CRR granting ONDs to Member States. This would complete the single rule book in financial regulation.

In the Bank Recovery and Resolution Directive (BRRD) there are gaps in the regulation of the so-called minimum requirement for own funds and eligible liabilities (MREL). These gaps may have negative implications on the conduct of macroprudential policy and financial stability. When demonstrating their adherence to the MREL, banks may include the Tier 1 and Tier 2 capital instruments that count towards Pillar 1 minimum capital requirements, Pillar 2 add-ons and CRD IV buffers. The relation between the MREL and regulatory capital requirements (Pillar 1, Pillar 2, buffer requirements) should be clarified, taking into account the agreed TLAC term sheet. This is of particular importance to clarify what consequences a breach of the MREL would have, in order to avoid an uneven playing field arising owing to different stances of the various resolution authorities within the EU.

C.2.2 Gaps in the macroprudential toolkit

To have an effective macroprudential framework Europe needs to urgently review its regulatory toolkit for banks. Authorities with macroprudential mandates should have the appropriate tools and procedures in place to be able to address sectoral and cross-border risks in the EU. This very basic principle should be the starting point of the European Commission's review of the CRR/CRD IV and the SSM Regulation. More specifically, this review should entail: (i) broadening the toolkit to include additional instruments, whilst ensuring instruments currently available are made more targeted and overlaps are eliminated or are at least significantly reduced; and (ii) fostering and streamlining the process to include, for instance, notification or information procedures both in the EU and within the SSM; and (iii) strengthening the macroprudential functioning of the ECB.

The macroprudential toolkit available to the ECB must be broadened to address specific types of systemic risk[35]. At the moment, some instruments that are available to national macroprudential authorities are outside the ECB's macroprudential toolkit because they are not present in the CRR/CRD IV, although they are extremely important in effectively addressing specific types of systemic risk. These include (i) various asset-side measures, such as the application of limits to

---

34 European Central Bank (2015), Draft Regulation on the exercise of options and discretions available in Union law, November. (Link)

35 See also the comments on the macroprudential framework in the ECB's Opinion (CON/2012/5) on the proposals for the CRR and CRD IV, p.6. (Link)

loan-to-value (LTV), loan-to income (LTI) or debt service-to-income ratios (DSTI), and (ii) the introduction of various exposure limits (such as sectorial exposure limits) that fall outside the current definition of large exposures. In addition, the scope of sectorial risk weights (currently available for real estate and intra-financial sector exposures) should be extended to include further exposure classes so that macroprudential authorities can address risks emerging in specific sectors in a targeted – and thus more effective – manner.

C.2.3 Inconsistencies in the area of retail payment systems and financial collateral

Some inconsistencies remain in the area of retail payment systems (and the implementation of the relevant directives) which prevent a consistent EU-wide level playing field. For example, national inconsistencies in granting access to retail payment systems designated under the Settlement Finality Directive, and the additional lack of clarity stemming from the revised Payment Services Directive should be addressed.

A further area where inconsistencies arise is the Financial Collateral Directive (FCD), in particular the mobilisation of credit claims as collateral for specific credit policy operations with central banks. The scope of discretion left to Member States in the FCD with respect to the implementation – into the national legal framework – of specific provisions could result in an uneven playing field across the Eurosystem. The diverging national practices that result may ultimately undermine the underlying rationale for the FCD's provisions on the mobilisation of credit claims as collateral with central banks.[36] This is of particular relevance with respect to the ability of debtors to validly waive their set-off rights vis-à-vis the creditors of the credit claims and with regard to the national handling techniques required to ensure the full effect of the mobilisation of credit claims as collateral to central banks vis-à-vis third parties.

C.2.4 UCITS V[37] may have unintended consequences on cross-border securities settlement and financial integration as a whole.

UCITS V may work against financial integration in respect of the cross-border settlement layer in the EU and might entail additional operational costs and risks for central securities depositary (CSD) link arrangements in the T2S infrastructure. Article 22a of the UCITS V Directive requires all sub-custodians, including custodian banks and investor CSDs, to individually segregate the accounts

[36] Recital 12 of the Financial Collateral Directive: "The simplification of the use of financial collateral through the limitation of administrative burdens promotes the efficiency of the cross-border operations of the European Central Bank and the national central banks of Member States participating in the economic and monetary union, necessary for the implementation of the common monetary policy."

[37] Directive 2014/91/EU on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions. (Link)

of UCITS funds. This goes beyond the segregation requirement for CSDs in Article 38 (5) of the Central Securities Depositories Regulation[38] (CSDR), pursuant to which clients generally have the right to choose between omnibus client segregation and individual client segregation – i.e. UCITS funds always have to choose the individual client segregation option. In addition, for the purposes of Article 38(5), the CSDR does not differentiate between investor and issuer CSD functions. Whilst UCITS V has the intention of reducing risks for UCITS investors, it might:

- create incentives for fund depositaries and their intermediaries to hold securities directly with a number of issuer CSDs instead of pooling their assets and collateral with one or a limited number of investor CSDs;
- have a considerable effect on the usage of CSD link arrangements, depending on the value and volume of the investment funds' underlying assets and segregated accounts;
- foster a model of disintegrated and fragmented access to European market infrastructures which is not conducive either to a model of single access via any CSD to the EU financial market nor to the financial integration objectives of the Capital Markets Union (CMU) and T2S;
- in the absence of an official interpretation of UCITS V, bring about the risk of national regulators imposing different account segregation requirements on their national CSDs and the link arrangements thereof, thus fostering non-harmonisation in post-trade processes.

It might be worth exploring whether the requirements in the UCITS V Directive should be amended and whether the CSDR requirements which provide for the protection of participants' assets by imposing rules to ensure the integrity of an issue, asset segregation and settlement finality (Articles 37 and 38) are sufficient at the CSD level.

D Rules giving rise to other possible unintended consequences

D.1 The shift towards market-based finance, as is being pursued in the Capital Markets Union agenda, represents a welcome increase in the diversity of the sources of finance supporting economic activity, but will need to be matched with measures to address any associated financial stability risks.

A notable post-crisis trend has been the growth of market-based finance. This is notably a result of regulatory reforms that may have increased the relative cost of bank-based finance, as well as long-term structural factors (e.g. changing demographics leading to asset accumulation) and cyclical factors (e.g. the search for yield). Some attention needs to be paid to changes in intermediation patterns and

[38] Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and Regulation (EU) No 236/2012. (Link)

financial structure, including possible shifts of activities to non-bank entities that are subject to less stringent regulation and are supervised without a systemic risk perspective (such as lending via non-banks or new forms of electronic money issuance).

A monitoring framework and macroprudential tools for the non-bank financial system need to be developed as non-banks also can exert costs on the wider financial system and become excessively risky and too big to fail. As the CMU is pursued, a broader and strengthened macroprudential toolkit for the non-bank financial system is warranted. Within the upcoming European Systemic Risk Board review the EU needs to broaden the toolkit to non-banks in order to prevent a build-up of systemic risk in parts of the financial system which are typically differently regulated and more opaque. Given the shift away from bank-intermediated finance, the potential macroprudential consequences of such a shift must be duly taken into account. In this context, a gradual approach to developing a framework for non-banks should be taken, in which, as a first step, supervisory coordination between the ESAs and the national competent authorities (NCAs) should be enhanced. For example, a macroprudential framework could be developed for insurance companies or asset management companies.

Pre-emptive policy measures targeting liquidity, redemption risk and stress tests should also be part of the macroprudential toolbox for non-banks. The build-up of leverage and the growing exposure to illiquid assets in the asset management sector are clearly relevant developments for macroprudential supervisors. A comprehensive toolkit to target these risks is therefore needed.

Haircuts for securities financing transactions are a further tool that could prove to be effective. Without countercyclical haircuts, in combination with the framework for minimum haircuts as outlined by the FSB, the effects on volatility and leverage in financial markets may turn out to present a material risk for financial stability. Authorities should therefore consider using haircuts as a macroprudential tool, for instance by raising the numerical haircut floors and varying them over time in a counter-cyclical manner.

Macroprudential intervention tools should be included in the EMIR. As with the tools discussed above for Securities Financing Transactions (STFs), macroprudential intervention tools could also be implemented for derivatives transactions (cleared and non-cleared). This could help to prevent the build-up of systemic risk resulting, in particular, from excessive leverage via derivatives, and further limit the pro-cyclicality of margins and haircuts. Such tools (for example, time varying minimum margin and haircut requirements) should be applied at the transaction level, after due consultation between the relevant EU authorities.[39]

---

[39] European Central Bank (2015), Response to the European Commission's consultation on the review of the European Market Infrastructure Regulation (EMIR), September. (Link)

Postal address 60640 Frankfurt am Main, Germany
Telephone +49 69 1344 0
Website www.ecb.europa.eu

ISBN 978-92-899-1900-5
DOI 10.2866/815982
EU catalogue No QB-04-15-346-EN-N