IRSG
INTERNATIONAL
REGULATORY
STRATEGY GROUP

THE CUMULATIVE IMPACT OF EU FINANCIAL SERVICES REGULATION: BETTER REGULATION FOR JOBS AND GROWTH

1.0 Introduction 03

2.0 Executive Summary 04

3.0 Summary of responses to call for evidence 06

4.0 Learning the lessons from the call for evidence 08

4.1 Principles for better regulation 08

4.2 Impact assessments 14

4.3 Regulatory forbearance 19

Annex 22

The International Regulatory Strategy Group

The IRSG is a practitioner-led and cross-sectoral body comprising of leading figures from the UK-based financial and related professional services industry. It seeks to identify opportunities for engagement with governments, regulators and European and international institutions to promote an international framework that will facilitate open and competitive capital markets globally. It is an advisory body both to the City of London Corporation and TheCityUK.

1.0 INTRODUCTION

The International Regulatory Strategy Group (IRSG) has welcomed the Commission's call for evidence on the EU regulatory framework for financial services. It has submitted an initial paper on 31 January 2016 and a detailed response on 10 March 2016, copies of which can be downloaded on TheCityUK's website[1]. This report *The cumulative impact of EU financial services regulation: better regulation for jobs and growth*, provides further detail of the IRSG's proposals on principles for better regulation, impact assessments and the need for regulatory forbearance.

The IRSG has welcomed the Commission's review into the cumulative impact of previous regulatory reform and believes that it is essential for the lessons from this review to be learnt and applied to ongoing and future initiatives, such as the *Green Paper on retail financial services* as well as global initiatives, such as Basel IV. Accordingly, this report explores how some of the issues identified in our response to the Commission's *Call for evidence – EU regulatory framework for financial services* could be avoided or minimised going forward by adherence to the recommendations made in this paper. It is hoped that the recommendations put forward in this report will contribute to the debate on better law-making. The IRSG stands ready to work with the Commission and other stakeholders to develop these proposals further.

The cumulative impact of EU financial services regulation: better regulation for jobs and growth sets out a number of recommendations which the IRSG believes should be adhered to in future legislative processes. These recommendations are addressed to the European Commission but should also be considered by the Parliament, the Council of the EU and the European Supervisory Authorities (ESAs), as all bodies play important roles in the EU's legislative process.

Reforming the legislative process could bring significant benefits to the European consumer and Europe's broader economy. By putting consumers at the heart of the wider Better Regulation Agenda and the Regulatory Fitness and Performance Programme, markets will work better and deliver more for the real economy, as well as for the consumers themselves.

[1] https://www.thecityuk.com/news/call-for-evidence-eu-regulatory-framework-for-financial-services/

2.0 EXECUTIVE SUMMARY: LEARNING THE LESSONS FROM THE CALL FOR EVIDENCE

The IRSG recognises that effective, practical and robust regulation is necessary for a strong, stable and supportive financial system: financial stability is a prerequisite to sustainable economic growth. Like the Commission, the IRSG is not advocating wholesale deregulation. The IRSG believes that it is appropriate to take stock and assess the impact of the regulation adopted during the past few years, particularly after a period of regulatory focus on the restoration of financial stability and confidence in the financial system. Financial services are key to the delivery of economic growth and each part of the financial system has a role to play: banking, insurance, asset management and market infrastructure. It is vital that financial services regulation permits and encourages each actor in the financial system to play its full role. Financial regulation needs to balance economic stability and the maintenance of fair and efficient financial markets with the need to facilitate innovation, growth and the taking of appropriately managed risks.

The IRSG has welcomed both the approach taken by the Commission in its call for evidence and the proposal for a Capital Markets Union (CMU) to develop and integrate European capital markets and diversify finance across the EU. It also supports the focus on jobs and growth adopted by the Juncker Commission. The IRSG believes that financial services regulation has a significant part to play in the creation of jobs and growth. It can facilitate a seamless and effective conduit for capital to reach business. It can support a dynamic, flexible and globally competitive EU that is open to cross-border activity, investment and the in-flow of capital from the rest of the world. The responses to the call for evidence, however, have identified a number of areas in which EU financial services regulation has not supported the jobs and growth agenda as it could. Having produced the evidence requested by the Commission on the cumulative impact of EU financial services regulation, the IRSG then considered what lessons could be learnt from the exercise.

As outlined above, the IRSG has considered ways to ensure that the shortcomings it identified could have been prevented or minimised. It specifically considered ways by which it could be ensured that EU financial services regulation supports prosperity, productivity and growth. It documented its preliminary conclusions in its response of 10 March 2016. First, it noted that many (if not all) of the shortcomings identified could have been avoided or minimised by adherence to a number of general framework principles which would ensure consistency, policy coherence, clarity and certainty, reduce duplicative and conflicting requirements and ensure an appropriate focus. Second, whilst welcoming the progress that has been achieved with regard to the impact assessment process, it commented that more work needs to be done in order to minimise unforeseen consequences, to ensure early identification of all consequences of the proposed legislation, to assess the cumulative impact of all proposals and to give clarity and certainty. Third, whilst noting the difficulties inherent in creating a tool which effectively and efficiently deals with unintended consequences, the IRSG recognises the need for some form of regulatory forbearance.

The IRSG recognises that work in this area has already begun, for example with the Economic and Monetary Affairs Committee's own initiative report *on stocktaking and challenges of the EU Financial Services Regulation: impact and the way forward towards a more efficient and effective EU framework for Financial Regulation and a Capital Markets Union*. It also recognises that more work in this area is necessary and the IRSG would welcome the opportunity to work further with the EU institutions in this regard.

In providing this report to the Commission, the IRSG recognises the unique role the Commission plays in the EU's legislative process with the right of initiative under Article 17(2) of the Treaty on the European Union. The IRSG recognises, however, that, in the vast majority of cases, the Council of the EU and European Parliament are the co-legislators. Additionally, the European Supervisory Authorities (ESAs) play an important role in advising the Commission, drafting level 2 legislation and level 3 guidance. Accordingly, the IRSG would welcome the engagement of the Council and Parliament with its proposals. The IRSG suggests that the points it makes on principles for better regulation and impact assessments are of relevance to the ESAs.

The IRSG's main recommendations are set out below:

Principles for better regulation	
R1	**Adoption of a regulatory code**
R2	**Adoption of Framework Principles on:** • Extraterritorial effect and the equivalence process • Proportionality/diversity • The legislative timetable • Consistency with international standards and other international approaches
Impact assessments	
R3	**Better Regulation Guidelines and evidence that these were considered**
R4	**Consideration of additional sub-questions for financial services impact assessments**
R5	**Production of revised impact assessment reports at key stages of the legislative process**
Regulatory forbearance	
R6	**Introduction of dynamic deadlines to deal with timetabling issues**
R7	**Inclusion of specified and clearly defined powers for the ESAs in EU legislation**
R8	**Development of a mechanism for National Competent Authorities to address issues restricted to one local market**

3.0 SUMMARY OF RESPONSES TO CALL FOR EVIDENCE

In its first two responses to the Commission, the IRSG identified a number of common shortcomings in EU financial services regulation. It also started to develop steps which could be taken to address these shortcomings and increase the support that EU financial services regulation gives to the jobs and growth agenda. These are summarised below for ease of reference:

1. *The need for harmonisation should be balanced with the need to recognise diversity, to ensure proportionate regulation and to facilitate the appropriate use of discretion.*

Examples of the need for harmonisation include inconsistent requirements relating to consumer disclosure, the form such disclosure must take and the inconsistent implementation of Alternative Investment Fund Managers Directive (AIFMD), as well as the diversity of inconsistent, and at times duplicative, measures set out in AIFMD, Central Securities Depositries Regulation (CSDR), European Markets Infrastructure Regulation (EMIR), Markets in Financial Instruments Directive II (MiFID II) and Undertakings for Collective Investments in Transferable Securities (UCITS) with respect to asset protection and segregation requirements.

Examples of the need to recognise diversity and to ensure proportionate regulation include the Capital Requirements Directive IV (CRD IV)/Capital Requirements Regulation's (CRR) treatment of investment firms as if they were banks and all entities within in its scope as if they were large multi-national banks, the disproportionate effects of the leverage ratio and the clearing obligation under EMIR and the impact of MiFID II and Basel III on non-financial entities.

2. *The consequences of legislative proposals require early identification and consideration. They should be regularly evaluated on an individual and cumulative basis.*

Almost all the examples cited in our response to the call for evidence demonstrate the need for early, regular and cumulative evaluation of the consequences of legislation.

3. *Financial services regulation ought to support a dynamic, flexible and globally competitive EU.*

Examples where regulation has not supported a dynamic, flexible and globally competitive EU include the gold-plating of international prudential standards which results in increased costs of raising finance in the EU, the inconsistent implementation of AIFMD which has meant that non-European Economic Area (EEA) AIFMs cannot access all European markets equally and the delay in recognising third-country Central Counterparties (CCPs) under EMIR which impedes cross-border transactions.

4. *The legislative process should facilitate the adoption of effective, efficient and timely regulation.*

Examples of problems with the effective, efficient and timely adoption of regulation include the setting of unrealistic deadlines in MiFID II/ Markets in Financial Instruments Regulation (MiFIR) and Bank Recovery and Resolution Directive (BRRD) and the delay in recognising third-country CCPs under EMIR. The problem is currently being repeated in Market Abuse Regulation (MAR) and Packaged Retail and Insurance-based Investment Products (PRIIPs).

5. *There should be a renewed focus on the consumer and what the consumer needs.*

Examples of where there is a need for a renewed focus on the consumer are found in many of our examples but particular examples include the inconsistent requirements relating to consumer disclosure and the form such disclosure must take, MiFID II's categorisation of certain products as 'complex' and the lack of specific consideration of vulnerable clients in the disclosure requirements.

4.0 LEARNING THE LESSONS FROM THE CALL FOR EVIDENCE

Principles for better regulation	
R1	**Adoption of a regulatory code**
R2	**Adoption of Framework Principles on:** **• Extraterritorial effect and the equivalence process** **• Proportionality/diversity** **• The legislative timetable** **• Consistency with international standards and other international approaches**

The IRSG has considered the better regulation codes that apply in a number of EU jurisdictions and sees advantages in the Commission adopting its own code building on its existing guidelines on Impact Assessments and Better Regulation. Doing so would create a flexible, principles-based framework for regulation which would allow the Commission to develop proposals for regulation that meet its policy objectives and which also suit the needs of the entities it regulates. Such a code, together with the further development of the impact assessment process (on which see pages 14 - 18) would also promote proportionate, consistent and targeted regulatory activity through the development of transparent and effective dialogue and understanding between the Commission and those it regulates.

RECOMMENDATION 1

Adoption of a regulatory code

The IRSG suggests that the Commission should adopt a regulatory code which includes better regulation principles, to which it would have regard when developing legislative proposals in addition to its other objectives, such as financial stability and consumer protection. The Code should include the following principles:

1. *The Commission will develop its legislative proposals in a way that supports prosperity, productivity and growth.*
    - This underlines that the Commission will consider the economic impacts of its proposals, minimising the costs of compliance for those it regulates and encouraging compliant businesses to grow through proportionate regulatory activity. The IRSG believes that promoting financial stability and growth are not mutually exclusive.

- The code could also involve the Commission in considering how it can reduce the regulatory burden and whether a "one in, one out" approach is appropriate in relation to legislative proposals that impose a compliance cost on those the commission regulates.
- It should also include consideration of the global competitiveness of the EU.

2. *The Commission will only develop legislative proposals if they are necessary and there is no alternative to legislation.*
    - This reinforces the fact that the baseline option which the Commission will consider is the option to do nothing (see page 15). This would not prevent the Commission encouraging options such as self-regulation. For example, industry has taken steps to promote best practice in the private placement market, as well as key principles and standard documentation. On 10 March 2015 the Pan-European Private Placement Working Group (PEPP WG) launched the Pan-European Corporate Private Placement Guide[2] (the "Guide") which it is hoped will develop into a market standard. Both the Loan Market Association and the French Euro Private Placement Working Group have published standard model framework documentation for both loans and bonds/ notes coordinated within the PEPP WG to which readers of the Guide are directed. The Commission welcomed this initiative which could further facilitate such market-led activity.

3. *The Commission will engage early with all relevant stakeholders, giving them the opportunity to offer their views and contribute to the development of policies.*
    - This makes clear the Commission's commitment to public consultation.
    - All consultations should be open for at least 12 weeks.
    - The Commission should give specific consideration to how it engages with non-EEA persons who may be affected by its legislative proposals.

4. The Commission will ensure that its approach to its regulatory activities is transparent and will provide a single conduit for amendments through the co-legislators.

5. The Commission will base its legislative policies on published risk assessments.

---

[2] See http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/private-placements/the-pan-european-corporate-private-placement-market-guide/

RECOMMENDATION 2

Adoption of Framework Principles on:
- **Extraterritorial effect and the equivalence process**
- **Proportionality/diversity**
- **The legislative timetable**
- **Consistency with international standards and other international approaches**

In addition to the general principles set out above, the IRSG believes that there would be value in the Commission adopting Framework Principles on a number of cross-cutting issues. These Principles should be applied in a uniform manner across all financial services legislation. Where, in exceptional cases, there is a need to depart from these Principles, the reasons for this departure ought to be set out in the impact assessment. The IRSG has focused its attention initially on the following areas.

A. Extraterritorial effect and the equivalence process

Policymakers should consider the cross-border implications at the onset of policy development to foster consistency with international standards and/or other jurisdictions and to mitigate barriers to equivalence at a later date. The IRSG suggests that consideration is given to the adoption of the following Framework Principles on cross-border implications:

I. The Commission will be explicit as to the global application of each specific provisions in each legislative proposal.
II. The Commission will explain any extraterritorial effect under international law by reference to the principles of territoriality, personality or universality[3] and will explain its approach as a matter of policy.
III. All extraterritorial provisions will be capable of being ameliorated by an equivalence determination.
IV. The criteria used to determine equivalence will, as far as possible, be consistent between and within dossiers.
V. The Commission can make full equivalence decisions or temporary/provisional equivalence decisions in all dossiers.
VI. Where the Commission has not made an equivalence decision, National Competent Authorities (NCAs) will be able to make equivalence assessments.
VII. The timetable for advice on equivalence to be provided to the Commission and for an equivalence decision to be made by the Commission should be set out in the level 1 text. Where these dates lapse without an equivalence decision being taken, national competent authorities will be able to make equivalence assessments.
VIII. Advice on equivalence and all forms of equivalence determinations will take into account differences in legal frameworks, local market practices and characteristics and the timetables for implementation of reform in the third country jurisdiction.
IX. Where possible, and in the absence of any form of equivalence determination, Member States should have a discretion to permit their national supervisors to apply other methods to ensure appropriate supervision rather than apply the EU legislation extraterritorially.

[3] Advocate General Kokott in Case C-366-10 ATAA v DECC (Opinion para 149) explains that under international law the exercise of jurisdiction is in general permitted only where the particular facts display a sufficient link with the State concerned. The particular connecting factor can be based on the territoriality principle, the personality principle or – more rarely – the universality principle.

The Principles at (iii)–(viii) are based upon the equivalence processes in Solvency II[4] and will, the IRSG believes, give the flexibility that is needed when an assessment has to be made of third country regimes.

B. Proportionality/diversity

The IRSG believes that the diverse nature of the actors in the financial services sector requires greater recognition and that there should be more proportionality in regulation for smaller firms, firms with lower risk profiles and firms with specific business models. To this end, the IRSG would suggest that the following Principles are adopted:

I. The Commission recognises that the same approach does not necessarily suit all firms.
II. In developing its legislative proposals, the Commission will consider the size, risk profile and business model of the firms that its policy objective requires it to regulate.
III. The Commission will impose the minimum obligations on the minimum range of firms necessary to achieve its policy objectives whilst taking into account the need to prevent regulatory arbitrage and competitive disadvantages.
IV. Where the Commission considers it is necessary to regulate firms of all sizes, risk profiles and/or business models to achieve its policy objectives, it will explain, at the earliest possible opportunity, the reason for its decision to all stakeholders.
V. Where the Commission considers it is necessary to regulate firms of all sizes, risk profiles and/or business models to achieve its policy objectives, it will consider whether it is appropriate to adapt the regime so as to reduce the regulatory burden for different firms or to apply or extend transitional periods for certain firms.

[4] Under Solvency II, all three forms of extraterritorial effect can be ameliorated by an equivalence decision by the Commission or, in two cases, an equivalence assessment by the group supervisor. In one case, in the absence of any form of equivalence determination, Member States also have a discretion to permit their national supervisors to apply other methods to ensure appropriate supervision rather than apply Solvency II extraterritorially. It is possible for the Commission to make full equivalence decisions or temporary/provisional equivalence decisions. A full equivalence decision lasts for an unlimited period, subject to regular review, and is used when the third country is already equivalent to the EU regime. Temporary/provisional equivalence decisions are used where a third country is working towards equivalence and it is an ongoing process. They last for 10 years (renewable for further 10-year periods) or for a set date.

C. The legislative timetable

There are increasing numbers of examples of the need to postpone the application date of EU legislation, often because necessary prerequisite steps, including the adoption of level 2 legislation, have not been taken in time. Some of these examples are set out at page 19 below. The IRSG recommends that the following Principles be adopted and applied when the Commission drafts legislative proposals:

I. The ESAs shall have sufficient time to conduct public consultations, carry out substantive cost benefit analyses develop advice, draft regulatory technical standards and implement technical standards of good quality.
II. Where the Commission is responsible for drafting delegated and implementing acts, the Commission shall have sufficient time to do the same.
III. In respect of regulatory technical standards and implementing technical standards, the timetable set out in Articles 10, 13, 14 and 15 of the regulations establishing the ESAs shall be followed.
IV. In respect of delegated and implementing acts, there shall be sufficient time for the procedures of the Council and Parliament or comitology respectively to be carried out.
V. Once the level 2 legislation has been adopted, Member States shall have sufficient time for any implementation.
VI. Once the level 2 legislation has been adopted and, if necessary, the Member States have implemented the EU legislation, the industry shall have sufficient time for implementation. In practice this means no less than 12 months.
VII. Where the legislation requires the creation or adaption of financial market infrastructure, sufficient time shall be allowed for the relevant financial market infrastructure to come into existence or adapt before market participants become subject to the relevant rules.
VIII. Only once all the above steps have been taken, shall the legislation come into force.

In addition to the adoption of the above Principles and to give effect to them, the IRSG believes that consideration ought to be given to the adoption of the "dynamic deadline" approach suggested by Germany in the negotiations concerning the MiFID II/MiFIR Quick Fix. Under this approach, the implementation and application deadlines would be tied to the dates of the entry into force of the level 2 legislation or to another prerequisite step.[5] Such an approach has already been followed in Article 69 of the Central Securities Depositories regulation where the application of the regulation depends on the adoption of regulatory technical standards.

[5] In respect of the Capital Requirements Regulation, where the Commission repeatedly had to adopt implementing acts to extend the transitional period for capital requirements for EU banking groups' exposures to CCPs pending the recognition of non-EU CCPs, the application of the provision as it applied to non-EU CCPs could have been linked to the adoption of equivalence decisions.

The IRSG recognises that a mechanism would be needed to ensure that the level 2 legislation is drafted in good time but believes that it would be possible to achieve this by setting target dates and, in respect of the ESAs, by holding the ESAs accountable for meeting those targets. For example, statistics on meeting the targets could be included in the Chairperson's report under Article 50 (Report) and the Commission's review under Article 81 (Review) of the regulations establishing the ESAs.

D. Consistency with international standards and other international approaches

The IRSG suggests the Commission adopt the following Principles regarding international standards and other international approaches:

I. Generally, the Commission will implement rather than diverge from international standards unless there is a demonstrable impact on the EU economy and its citizens.
II. The Commission will consider convergence with regulation seeking to achieve the same objectives in other major jurisdictions.
III. The Commission will consider the impact of diverging from international standards and/or other major jurisdictions on cross-border business, both for EEA persons doing business outside the EEA/with non-EEA counterparties and for non-EEA persons doing business in the EEA/with EEA counterparties.
IV. The Commission will explain its reasons for diverging from international standards and / or other major jurisdictions and its assessment of the impact of its decision on cross-border business to stakeholders and any equivalence determinations at the earliest opportunity.
V. The Commission will promote international consistency.

The IRSG suggests the Commission adopt the following Principles regarding international standards and other international approaches:

A. Subsidiarity and proportionality
B. Harmonisation
C. Consumer protection
D. Disclosure
E. Asset protection

4.2 Impact assessments

R3	Better Regulation Guidelines and evidence that these were considered
R4	Consideration of additional sub-questions for financial services impact assessments
R5	Production of revised impact assessment reports at key stages of the legislative process

The IRSG agrees that impact assessments are essential tools in the policy-making process. They enable evidence to be gathered and analysed to test whether a problem exists, to identify its underlying causes, to determine whether EU action can best address the problem and to assess the various options available. They should also be used to identify and evaluate the cost and benefits of each option, including the option of taking no action at all.

The IRSG welcomes the progress that has been achieved with regard to the impact assessment process but believes more work needs to be done in order to minimise unforeseen consequences, to ensure early identification of all consequences of the proposed legislation and to assess the cumulative impact of all proposals.

RECOMMENDATION 3

Better Regulation Guidelines and evidence that these were considered

According to *Chapter III Guidelines on Impact Assessments, Better Regulation Guidelines (2015)* the questions that an impact assessment should answer are as follows:

1. What is the problem and why is it a problem?
2. Why should the EU act?
3. What should be achieved?
4. What are the various options to achieve the objectives?
5. What are the economic, social and environmental impacts and who will be affected?[6]
6. How do the different options compare in terms of their effectiveness and efficiency identifying separately the benefits and costs for both the providers of financial services and their customers?
7. How will monitoring and subsequent retrospective evaluation be organised?

[6] The IRSG recognises the argument that it is difficult to quantify such impact at the developmental stage but believes that conclusions may be drawn by relying on the Commission's own logical deduction of the consequences of the proposed legislation and the responses to consultations. One of the points of the impact assessment procedures is to identify and address potential problems before they arise.

The IRSG welcomes and agrees with the guidelines on what should be considered in the context of each of the above questions. As the Better Regulation Guidelines (the Guidelines) were only adopted in May 2015, it is too early to assess the impact of the guidelines but the IRSG hopes that going forward Impact Assessment Reports will make it clear when addressing each question how consideration has been given to all the points made in Chapter III. The IRSG draws particular attention to question 4 and notes that when designing policy options, the Commission should always consider:

- The option of changing nothing (also known as the "baseline"): The "baseline scenario" should always be developed and used as the benchmark against which the alternative options should be compared. As such, it should take account of both national and EU policies in place and reflect possible developments, of these in the absence of new EU-level action. It should also try to anticipate important technological or societal developments such as the pervasive role of the internet and other Information and Communication Technology (ICT);
- The option of improving implementation and enforcement of existing legislation;[7] or doing less/simplifying existing legislation;
- Options that take account of new technological developments. All new initiatives should be "digital and internet ready" and operate effectively both in the digital and the physical worlds;
- Alternative policy approaches: e.g. different policy content/approaches to reach the objective;
- Alternative policy instruments: e.g. non-regulatory alternatives; self- or co-regulation; market-based solutions; regulatory alternatives; international standards, and their mix;
- Alternative scope: for instance, is the "think small first" principle taken into account; are micro-enterprises excluded from the scope of any proposed legislation".

Evidence that all of these options have been considered by the Commission when considering each legislative proposal would be welcome.

[7] It is important, however, that enforcement of existing legislation is consistent with the policy intent of that legislation and not a new policy objective.

RECOMMENDATION 4

Consideration of additional sub-questions for financial services impact assessments

The IRSG suggests that, in the context of financial services, impact assessments should also consider the following sub-questions:

1. What is the problem and why is it a problem including:
   A. Has there been a market failure?
   B. Is there a threat to financial stability?
   C. If there is neither a market failure nor a threat to financial stability, what is the problem and why is it a problem that the EU should address?

2. What are the various options to achieve the objectives including:
   A. Do any of the options diverge from international standards or other global approaches?
   B. What impact would regulatory divergence have on cross-border activities, both in respect of the global competitiveness of EEA firms and in respect of the ability of non-EEA firms to do business in the EEA?

3. What are the economic, social and environmental impacts of legislation and who will be affected including:
   A. Does the legislation promote jobs and growth?
   B. What is the impact on the end-user/consumer?
   C. What is the impact on the global competitiveness of the EEA in respect of cross-border activity, investment and the in-flow of capital from the rest of the world?
   D. What is the impact, both direct and indirect,[8] of the scope of the legislation?[9]
   E. What is the impact, both direct and indirect[10] of any extraterritorial scope?
   F. What is the macro-economic impact, including the impact on markets and behaviour?
   G. What is the impact on liquidity?
   H. How does this legislation add to the cumulative impact of legislation on the financial services sector?[11]

[8] The impact on those not directly within scope of the regulation but who are indirectly affected because their within-scope counterparties require their compliance to meet their own obligations should be specifically considered.
[9] The impact of a wide scope as opposed to a more proportionate approach which, for example, excludes smaller financial institutions ought to be specifically considered.
[10] Ibid.
[11] In considering the costs and benefits under question 6, regard should be paid to the addition to the cumulative cost of financial services legislation.

RECOMMENDATION 5

Production of revised impact assessment reports at key stages of the legislative process

The IRSG further believes that an impact assessment should be a living instrument used at critical stages in the legislative timetable to test the ongoing validity of assumptions. Without the Impact Assessment Report being updated as the legislative proposal develops, there is a risk that the report quickly becomes out of date as the Commission's original legislative proposal is amended by the Council and Parliament independently and then in trialogues. The result is, not only that the original impact assessment is no longer accurate, but that legislative provisions can be adopted without ever having been subject to an impact assessment.

The IRSG believes that Impact Assessment Reports should be available at key stages in the legislative process so that the Commission can assess whether the amendments made to the legislative proposal change the assumptions made to date and so that the co-legislature is aware of the impact of the legislation which it is proposing to adopt at all stages. The IRSG, therefore, suggests building on the current process as follows:

1. An Inception Impact Assessment should be published as is currently the case so as to allow stakeholders to be informed and to provide feedback and evidence in relation to the problem, possible policy options and their likely impacts.
2. An updated Impact Assessment Report should be published with the Commission's proposal for legislation as is currently the case.
3. An Impact Assessment Report should be published prior to the commencement of trialogues which updates the previous report in light of significant amendments proposed by the Parliament and Council to the Commission's proposal. Consideration would need to be given as to what would amount to "significant" in these circumstances. As a starting point, the IRSG would suggest that changes to the scope of the Commission's original proposal and the addition or removal of requirements, obligations or liabilities should be regarded as "significant". This includes where changes are mandated by the co-legislators. The Commission shall be responsible for determining in a transparent manner the meaning of "significant" in this context.
4. An Impact Assessment Report should be published subsequent to the trialogues but prior to the Parliament's plenary vote and adoption of the Council's common position. This Impact Assessment Report should be carried out on the text agreed in trialogues. If the legislation adopted reflects the text evaluated in this Report, it could replace the final Impact Assessment Report. Otherwise a final report would remain necessary.
5. An Impact Assessment Report should be published post-implementation, for example one year post-implementation, in order to ascertain whether the assumptions set out in the previous Report remain valid. If they do not, consideration should be given as to whether amendment or even repeal of the legislation is necessary.
6. Post-implementation, an Impact Assessment Report should be carried out in the event of significant international developments to determine whether it is necessary to amend or repeal the EU legislation to ensure international consistency. This is in addition to the wider post implementation reviews after a certain period of time which are already common practice.

The process set out above thus introduces potentially three new stages (stages 3, 5 and 6) at which Impact Assessment Reports would be produced. The IRSG appreciates that the European Parliament and the Council have made commitments to provide additional analyses to support any substantive amendments they propose but believes that a formal process, as set out above, is required to ensure the same rigour is applied to amendments as is applied to the Commission's original legislative proposal. All provisions of the adopted legislation should be subject to the same impact assessment procedure. Many national legislators follow such a procedure including Finland, the Netherlands and the UK, as does the Securities Exchange Commission in the US.

The process set out above assumes adoption on the basis of a negotiated first reading agreement. If the legislative proposal proceeds to second reading or to the conciliation procedure, the IRSG would suggest that Impact Assessment Reports be produced alongside the Commission opinion on the Parliament's amendments to the Council's common position, the Council's amended common position and joint text.

As noted in the introduction, this report is provided to the Commission. The IRSG, however, believes a similar approach should apply to the cost-benefit analyses carried out by the ESAs.

4.3 Regulatory forbearance

R6	**Introduction of dynamic deadlines to deal with timetabling issues**
R7	**Inclusion of specified and clearly defined powers for the ESAs in EU legislation**
R8	**Development of a mechanism for National Competent Authorities to address issues restricted to one local market**

Many respondents to the call for evidence have identified a need for some form of regulatory forbearance at EU level. Comparisons have been drawn with the US where use is made of no action letters. The IRSG recognises that the need for a tool by which urgent and critical action can be taken may arise in the following circumstances:

- Legislative timetabling issues
- Specific situations with individual legislative acts
- Issues restricted to local markets

RECOMMENDATION 6

Introduction of dynamic deadlines to deal with timetabling issues

Legislative timetabling issues have arisen which, it has been suggested, could have benefitted from, or may need, a form of regulatory forbearance, for example:

A. Solvency II, where two "Quick Fix" Directives were required to delay the application date.
B. CRR where the Commission had repeatedly to adopt implementing acts to extend the transitional period for capital requirements for EU banking groups' exposures to (CCPs) pending the recognition of non-EU CCPs.
C. MiFID II and MiFIR, where a Quick Fix to delay the application of MiFID II, MiFIR and certain aspects of the MAR was agreed on 2 May 2016.
D. MAR, which applies from July 2016 although as at the time of writing the RTS are in the process of being approved/ finalised and ESMA is yet to publish its proposed accompanying implementation guidelines.
E. PRIIPs, which applies from December 2016 although at the time of writing the level 2 legislation has yet to be adopted.

The IRSG does not believe that regulatory forbearance is the only option to deal with these problems. If the suggestion of a dynamic deadline set out at page 12 were adopted, the issues detailed above would not have arisen and there would be no need for Quick Fix solutions or regulatory forbearance in this area.

RECOMMENDATION 7

Inclusion of specified and clearly defined powers for the ESAs in EU legislation

Specific situations may arise in individual legislative acts. For example, an issue has arisen as to how the clearing obligation established under the EMIR can be suspended or terminated.

Currently, the suspension or termination of the clearing obligation for a specific class of derivatives under EMIR can only be performed through the amendment of the relevant regulatory technical standard. As the need for suspension or termination will inevitably result from significantly disruptive market events, there is unlikely to be time for the legislative process to be completed.

The IRSG believes that a solution can be developed that is compatible with the EU's legislative architecture and the case of *Meroni*[12] which provides that EU institutions may delegate powers to independent, executive or regulatory bodies as long as the delegation relates only to clearly defined executive competencies, meaning that no power which may make possible decisions on policy choices may be granted to the delegated body. In *Meroni* a distinction was made between "clearly defined executive powers the exercise of which can, therefore, be subject to strict review in the light of objective criteria determined by the delegating authority" and "a discretionary power, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy". The former can be delegated to a European agency but the latter cannot.

The regulation establishing ESMA contains provisions permitting action in an emergency (Article 18 (Action in emergency situations)) and action where there is a threat to the orderly functioning and integrity of financial markets or the stability of the whole or part of the EU financial system which fall short of an emergency situation (Article 9(5) (Tasks related to consumer protection and financial activities)). The IRSG believes that it is possible that the need to suspend or terminate the clearing obligation may arise because of adverse developments that may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the EU financial system that would trigger Article 18.

The IRSG is of the opinion, however, that it is also necessary to consider a mechanism for suspending the clearing obligation when the circumstances do not amount to an emergency situation as envisaged under Article 18. The IRSG believes that EMIR could be amended to give ESMA the power to suspend the clearing obligation in accordance with Article 9(5) of the regulation establishing ESMA and in a manner that is compatible with *Meroni*. There would be no need to give ESMA the power to terminate the clearing obligation because, if a suspension were in place, there would be time for the legislative process to run its course.

Further detail can be found in the annex.

[12] Case 9/56 Meroni v High Authority [1957 & 1958] ECR 133.

RECOMMENDATION 8

Development of a mechanism for National Competent Authorities (NCAs) to address issues restricted to one local market

The need for regulatory forbearance may arise because of an issue that arises in a local market which does not have immediate cross-border implications but which is of systemic significance in the local market and might become of EU-wide systemic relevance were action not taken as a matter of urgency. As the short selling and benchmark regulations demonstrate, it is possible to develop a mechanism that permits NCAs to take action whilst imposing sufficient controls to ensure that the authorities do not act to give their markets or firms an advantage nor to fracture the internal market.

Where there is a clear need for a localised solution, the IRSG suggests that the relevant level 1 text specifically addresses this need as has been done in the short selling and benchmark regulations. The IRSG would advocate a solution that is consistent with that adopted in those two regulations but with an added control based on Article 17 of the regulations establishing the ESAs. For example:

The level 1 text could give NCAs the ability to respond to the specific issue by, for example, considering whether it is appropriate to disapply the legislation either generally or in response to an application by a financial institution.

A. The level 1 text could give NCAs the ability to respond to the specific issue by, for example, considering whether it is appropriate to disapply the legislation either generally or in response to an application by a financial institution. The following process, which is modelled on the process in the short selling regulation with the additional control of Article 17 (Breach of Union law) of the regulations establishing the ESAs, could apply.

   I. The level 1 text should set out the grounds which would trigger the use of the NCA's power.
   II. Before imposing any decision, the NCA must notify the relevant ESA and the other NCAs of the decision it proposes to take no less than 24 hours before the decision is intended to take effect. In exceptional circumstances, the NCA may make the notification less than 24 hours before the decision is intended to take effect where it is not possible to give 24 hours' notice. A notification shall, however, be made before the decision is intended to take effect.
   III. The level 1 text should set out what details should be included in the notification.
   IV. The NCA shall also publish on its website details of the decision including the reason for the decision.
   V. After receiving the notification to which there is reference at sub-paragraph (ii) above, the relevant ESA shall issue an opinion within a set timeframe on whether it considers the measure is an appropriate and proportionate use of the power conferred on the NCA under the level 1 text or whether it considers that the NCA has not complied with Union law in making the decision, in which circumstances Article 17 (Breach of Union law) of the relevant ESA regulation shall apply.

ANNEX

Further to what is set out in recommendation 7 (page 20), the IRSG believes that the need to suspend the clearing obligation will arise in specific and extremely remote circumstances which could be identified in advance. For example:

Scenario 1: The need for suspension arises due to a sudden, sustained and material drop in liquidity for a mandatory cleared product. This particular case could, for instance, arise in the event of one or multiple defaults of major market participants. In such a scenario, while the CCPs may have successfully managed the defaults, they could retain significant exposure on some illiquid products, with insufficient market capacity to manage a subsequent default. In this specific case, the suspension of the clearing obligation could enable market participants to close out their cleared positions and revert to uncleared contracts, as required.

Scenario 2: The need for suspension arises because a major CCP fails to operate, either as a result of a CCP default or of operational incapacity. It is important to note that a CCP entering into recovery or resolution should not be, in and of itself, a trigger for suspending clearing obligations. The resolution authority, in cooperation with the relevant authorities, will be best placed to assess whether the clearing obligation should be maintained, either through the transfer of positions and clearing activities to another viable CCP, or through other actions.

The IRSG suggests that EMIR be amended to give ESMA the power, in accordance with Article 9(5), to suspend the clearing obligation in specified circumstances and in accordance with clearly defined criteria. As the central clearing mandates result from G20 commitments and are established to secure market stability, the criteria should require ESMA to consult the relevant authorities and take into account the macro-prudential perspective, the benefits of central clearing in terms of systemic risk reduction, the current market conditions, the implications of reverting to bilateral transactions and the corresponding margining framework.

MAYER • BROWN

Mayer Brown is a global legal services provider advising many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest banks. Our legal services include banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

Please visit www.mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

The IRSG wishes to thank the members of the steering group which has overseen production of the report. The IRSG would also like to thank Alexandria Carr and Mayer Brown for their work on this project and all those who gave their time to discuss the content of this IRSG report during its preparation.

For further information about this report, please contact:

Nicky Edwards, Director of Policy and Public Affairs, TheCityUK
nicky.edwards@thecityuk.com

Kerstin Mathias, Head of Policy, TheCityUK
kerstin.mathias@thecityuk.com

This report is based upon material in possession of TheCityUK Limited or supplied to us, which we believe to be reliable. Whilst every effort has been made to ensure its accuracy, we cannot offer any guarantee that factual errors may not have occurred. Neither TheCityUK nor any officer or employee thereof accepts any liability or responsibility for any direct or indirect damage, consequential or other loss suffered by reason of inaccuracy or incorrectness. This publication is provided to you for information purposes and is not intended as an offer or solicitation for the purchase or sale of any financial instrument, or as the provision of financial advice. Copyright protection exists in this publication and it may not be reproduced or published in another format by any person, for any purpose. Please cite source when quoting. All rights are reserved.

IRSG
INTERNATIONAL
REGULATORY
STRATEGY GROUP

DOMINE DIRIGE NOS
CITY OF LONDON

TheCityUK