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Dear Commissioner Hill,

We are writing to express our support for the remarks you made in your speech at the Capital Markets Union conference on 6 November.

The Anglo-French Committee of the City of London Corporation and Paris Europlace brings together senior industry representatives from London and Paris with the aim of shaping financial service regulation in areas of mutual interest.

During your speech, you spoke of the need to re-evaluate all of the financial services regulation that has been passed over the past 5 years to see whether the EU has got the balance right between reducing risk and encouraging growth in financial services regulation, and in particular whether we might need to fine tune regulation to make investment flows easier.

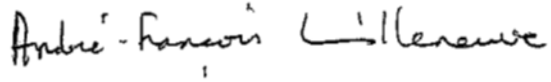
We fully agree that a “bonfire” of regulation would not be helpful but that we need a period of stability in order to review and assess the new regulatory framework. While the full extent of the impact of the new regulation framework will not be clear until it is fully implemented in 2019, we do believe that there are already areas where improvements could be made to ensure that financing to the real economy is optimised, which we have set out in the annex to this letter.

We hope that you will be able to take our recommendations into consideration and are at your disposal should you wish to discuss this further.

Yours sincerely,

Mark Boleat

Mark Boleat
Chairman of Policy and Resources Committee, City of London
Member of the Anglo-French Committee



André Villenueve
Co-chair, Anglo-French Committee

Vivien Levy-Garboua
Co-chair, Anglo-French Committee
Paris Europlace

ANNEX

Level 1 measures currently under consideration that should be revised or withdrawn

1. Financial Transaction Tax

We do not believe that a Financial Transaction tax is compatible with the European Commission's stated aims of promoting jobs, growth and investment.

The FTT would conflict with the desired aim to diversify the funding sources for corporates so that their reliance on bank funding is reduced. At a time when bank funding is constrained, the main alternative avenue for funding is the financial markets. However, the use of the capital markets, which is already underdeveloped in the EU compared with some other economies, will be further disincentivised as these transactions will be subject to FTT, and therefore more expensive, whereas bank loans will not and will therefore be relatively cheaper.

2. Banking structure reform

There are compelling arguments for reviewing the proposal made by the previous Commission on the structural reform of banks as part of the Better Regulation initiative. Not only are banks well capitalised and able to withstand significant shocks (as exemplified by the recent AQR and stress tests), but the current reform proposals are likely to damage the ability of banks to provide liquidity to markets (over and above some of the measures noted below) and service customers, in particular SMEs, and thus undermine economic growth. With the new focus on the creation of a Capital Markets Union, it is right that this proposal be re-examined to ensure that it does not undermine efforts to promote market financing of the European economy.

Finally, there are measures that have been adopted already at national level, the implementation of which would be subject to substantial uncertainty and delay if the Commission proposals were adopted. These national measures appear to provide appropriate remedies therefore with respect the principle of subsidiarity EU measures might be judge unnecessary.

Level 2 measures that could be better defined and calibrated:

1. Leverage Ratio

There is evidence that banks are already shrinking Rates/Repo business and liquidity in those products may be challenged by smaller and less elastic balance sheets. Repo markets are crucial to short-term liquidity. It may also impact on Prime Brokerage activities. Ultimately, the leverage ratio impacts on incentives for client clearing which may increase end-user pricing or impact participation in certain markets.

We therefore need to avoid the **Leverage Ratio** becoming a primary constraint on market makers' balance sheet capacity instead of the back-stop measure that it was intended to be. A couple of clarifications designed to ensure that the leverage exposure is appropriately calculated for securities financing, in particular for repo and reverse repo would be:

(a) ensure that netting is recognised as always applicable for trades cleared with CCPs and for bilateral trades with the same counterparty settling across the same system (as the delegate act recitals helpfully indicate);

(b) clarify that operational risk is dealt with in the capital rules and therefore should not be included in the leverage exposure calculation.

2. Net Stable Funding Ratio

The NSFR impacts on dealer funding costs to make markets (equities and securities financing transactions) and to support new issuance, as well as impacting Reverse Repo, which are used to managed inventories. It, therefore, reduces market makers' balance sheet elasticity to absorb inventory given increased stable funding costs.

Without reverse repo or with a costly reverse repo, market makers would have to locate bonds before they could provide quotes to investors willing to buy, significantly reducing liquidity. To avoid the NSFR making reverse repo uneconomic, we would recommend that the level of stable funding required for reverse repo using LCR HQLA assets such as government bonds be set at the level of the haircut applied in the LCR, consistent with the approach applied to long cash security positions. We would further recommend that a zero stable funding weighting be applied to reverse repo for surplus liquidity deployment, and short covering.

Furthermore, the NSFR may have a negative impact on the funding of European firms, either to export or for their short term needs:

a) We would suggest that the Commission considers the read-across between the LCR and the NSFR on international trade finance loans, which are usually short-term and self-liquidating. It would seem somewhat illogical to permit a 100% inflow rate for trade finance loans for LCR and then to require 50% stable funding (as proposed by the Basel Committee in BCBS 295). A better solution might be to treat such loans as analogous to unencumbered loans to financial institutions (which attract a 15% required stable funding requirement) and then decided if this requires some level of funding if less than 6 months to maturity.
b) The same is true for factoring, which is the number 2 solution for short-term bank funding for businesses, after overdrafts, with the operating loan needs of businesses hitting a record high in 2013 owing to persistently lengthy payment deadlines. The NSFR will further penalise an activity already encumbered by the anxiety gripping VSEs and SMEs over their short-term funding and cash flows.

As regulators reconsider the prudential treatment of **sovereign exposures**, either by requiring risk weighting, introducing Loss-Given-Default (LGD) and/or Exposure-At-Default (EAD) floors, and withdrawing IRBA model approval or flooring at Foundation levels (as the UK PRA, for example, has recently proposed). Any such changes should be consistently and uniformly calibrated, not taken in isolation, given the critical interaction with liquidity and leverage requirements.

3. MiFID

We need careful calibration of the new **transparency requirements** for bond markets under MiFID, currently under consideration by ESMA, to avoid further increasing market makers' risk, given that unwinding large positions will be more visible and take longer with smaller inventories and reduced liquidity. From this perspective, we would suggest that any post-trade transparency requirement on non-equity instruments include a cap above which the information would be publicly disclosed in a timely manner as to whether the amount of the transaction was equal to or above the cap and which would exclude the Legal Entity Identifier (LEI) of the market maker executing the transaction.

4. Securitisation

If we are to revive the securitisation market, we need to look again at the prudential rules for exposures to securitised assets. The treatment of high quality securitisations in Solvency 2 and CRD4 should be re-calibrated to ensure that both banks and insurers can hold these instruments without being subject to punitive capital charges.

- **Solvency II** – Capital charges for institutional investors remain too high despite recent EU re-calibration for Level 1 High Quality Securitisations (HQS). This must be adjusted when the legislation is reviewed if the ABS investor base is to widen.

- **The 2nd iteration of Basel proposals will result in a capital treatment that is improved but still too harsh**. Capital would be around 7.5 times higher than levels applied for un-securitised assets of the same quality.

5. EMIR (reporting)

It is right for improved supervisory oversight that derivatives (together with related collateral movements) be reported into a central database (ie, trade repository) but this does not require both sides to the transaction to report. As long as one side reports – and is required by law to do so – then the risk positions will be captured. Consideration should therefore be given to moving to 'one-sided' reporting (as practised in other jurisdictions), especially as many end-users already delegate reporting to dealer firms anyway. This would reduce the burden on end-users, for whom derivatives remain an important but increasingly expensive tool.