Position paper

EC's Green Paper on Building Capital Markets Union

EUROPEAN PRINCIPAL TRADERS ASSOCIATION

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FIA EPTA

The European Principal Traders Association (EPTA) is affiliated with the Futures Industry Association ("FIA") and is comprised of 26 EU-based proprietary trading firms that deal on own capital in the exchange-traded markets. FIA EPTA members engage in manual, automated and hybrid methods of trading and are active in a variety of asset classes, such as cash equities and futures, foreign exchange, commodities and fixed income. Members of FIA EPTA are a critical source of liquidity in the exchange-traded markets, allowing those who access the markets to manage their business risks efficiently. We believe that stable, reliable and well-functioning markets increase security and safety and provide the foundations that encourage investor confidence, which is key to economic growth.

Green Paper on Building a Capital Markets Union

FIA EPTA welcomes the European Commission's Green Paper on Building a Capital Markets Union. In the aftermath of a severe financial and economic crisis, Europe is still struggling to return to even keel, reduce unemployment and stimulate economic growth. We therefore applaud the aims of the Capital Markets Union to increase capital markets' effectiveness, efficiency and size and believe it is critical that the current post-crisis regulatory framework supports, rather than impedes, these goals.

We support the direction of the Green Paper, including its three main objectives:

1. Improving access to financing for all businesses across Europe (in particular SMEs)
2. Increasing and diversifying the sources of funding from investors in the EU and all over the world; and
3. Making markets work more effectively and efficiently, linking investors to those who need funding, both within Member States and cross-border.

FIA EPTA strongly believe capital markets are the key to diversifying the means by which companies of all sizes can obtain access to capital, as well as to lowering Europe's dependency on banking channels for funding. Open markets are the best way to allocate capital efficiently, as they facilitate the flow of funds between individuals and other entities, matching the wealth of savers with those who can put such funds to beneficial use, and generate flexibility for investors to enter and exit investments whenever they choose.

Moreover, the relationship between healthy capital markets and the economy generally is palpable; growth in stock markets correlates directly with real economy growth on one-to-one basis. Therefore the liquidity of secondary markets, where investors trade among themselves, is key to the healthy functioning of primary markets in making it easier for companies (including SMEs) to raise capital throughout Europe while ensuring effective investor protection as well as in fostering sustainable economic growth and driving employment across Europe.

In addition to accessing funding, companies need markets in order to have the ability to hedge and minimise risks. We echo the comments made by FIA Europe and ISDA that next to capital markets, related derivatives markets are also essential for the Capital Markets Union, as derivatives play a crucial role throughout the value chain ensuring that risks that arise from price fluctuations can be hedged. Derivatives not only enable companies to hedge market risks, but also allow market intermediaries, such as market makers, to manage securities inventories more efficiently. Without derivatives, securities markets would exhibit much lower levels of liquidity, which means transaction costs for issuers and investors would be much higher.

However, as the Commission rightly states, the size of capital markets ultimately depends on the flow of savings into capital market instruments. Thus, for markets to thrive, they need to attract institutional, retail and international investors, and, **importantly, they require intermediaries with short- and medium term trading horizons to facilitate the transactions among longer-term investors – in other words, a varied and broad ecosystem of participants is essential**.

Attracting more, including foreign, investment into Europe is crucial to ensuring European markets have and maintain this healthy ecosystem of participants. To achieve this, we agree with the Commission's comment that European markets must be open and globally competitive, well regulated and integrated, and that, given the global nature of capital markets, it is important to take into account the wider context.

Retaining the competitiveness of European markets is vital, as without this, there is a grave risk that companies will begin to transfer new investments, or parts of existing operations, out of Europe to the US or Asia. We therefore strongly believe regulation should be harmonised within the G20 framework to maintain Europe's global competitiveness.

We note that the EU has promulgated a significant and almost unprecedented amount of markets regulation, covering both prudential aspects and conduct of business, in the last five years. Since the financial crisis, the Single EU Rulebook has introduced markets regulation that is intensive, high-impact and broad in scope (e.g. through CRR/CRD IV, EMIR MAR/MAD II, and MiFID II), with hundreds of Delegated and Implementing Acts relating to MiFID II, Solvency II, and CRD IV still in progress and pending adoption / implementation.

The pace and breadth of rule-making has placed a heavy burden on both European market operators and participants, which cannot help but increase the pressure on the operational framework of these firms as they struggle to respond to and prepare for such significant changes, the true impact of which has in most cases not yet fully materialised. Therefore, we would strongly question the advisability of issuing further regulation as part of the Capital Markets Union program; rather, we believe a practical agenda for achieving the Capital Markets Union objectives should include reviewing existing European legislation affecting markets. Any such review should be designed to ensure that market participants critical to the functioning of markets are not overly hindered by legislation; therefore, time is of the essence to mitigate the impact of unintended consequences.

In particular, points we believe call for urgent review include:

- **Third country impact**: ensuring that equivalence decisions are granted in a timely manner and obstacles to participation in European markets by third country firms are avoided. For instance, third country firms that wish to trade in European markets should not be unnecessarily prevented from doing so by applying MiFID II authorisation requirements in an extra-territorial manner. Further, requirements imposed by host Member States on market operators with a European marketing passport granted by their home Member State should not create unjustified barriers to the free movement of capital;
- **Technical standards for MiFID II/R and the regulatory burden on small and medium financial market enterprises:** ensuring that finalisation of rules on microstructural issues, transparency, and investor protection do not have the unintended consequence of further harming market liquidity by reducing, rather than enhancing, the number of existing participants in the market ecosystem or deterring new participation in markets. In particular, we urge the Commission to ensure that European market regulation promotes, rather than restricts, the innovation and development of new technologies as an important driver of the integration of capital markets that have contributed, for example, to the development of today's highly transparent electronic trading platforms, the pricing and cost efficiencies made possible by algorithmic low-latency trading, and the competition and innovation ushered in by "FinTech" companies, by ensuring regulatory authorities apply the European law principle of proportionality based on the nature, size and complexity of affected firms. The effective support of non-financial SMEs and their financing through capital markets goes hand in hand with an effective support of "financial SMEs": small and medium banks, investment firms or collective investment schemes may be more motivated than big financial institutions to invest into or act as providers of liquidity for SMEs, however they are also more vulnerable to extensive and high impact regulation;

- **Provisions on market making**: ensuring rules applicable to market makers are not disproportionate and do not have the consequence of decreasing the number of liquidity providers and thus overall quantity and quality of liquidity in European markets. We are concerned that the current regulatory and market environment serve to render the market-making model uneconomic and obsolete. Therefore, it is very important that regulation should be designed to promote the sourcing of liquidity between buyers and sellers and enhanced short- and medium-term intermediation, including attention to pre- and post-trade transparency requirements, a review of mandatory buy-in regulation with respect to market makers, and the provision of capital relief and proportionality on remuneration models for independent market-making firms;
- **Capital/prudential requirements under CRR/CRD IV**: ensuring that prudential regulation does not have the unintended consequence of making it prohibitively expensive or impossible to continue to operate in the markets. In particular, independent market making firms that deal exclusively on own account, do not hold third party monies, provide services to the market place rather than named clients and therefore do not present systemic risk, should be granted relief from CRR/CRD IV capital requirements to enable them to continue to efficiently and nimbly fulfil their important role in providing liquidity to markets;
- **Non-discriminatory access to trading venues**: ensuring detailed legal safeguards to achieve transparent and non-discriminatory access rules for OTC derivative trading venues. Only then will it be possible to ensure that organised trading facilities under MIFID II specify access parameters in an open and transparent manner rather than using their defined ability to determine and restrict access based on obligations to customers. Any criteria that explicitly or implicitly exclude an entire class or category of otherwise eligible market participants by definition involve discrimination. A true all-to-all market place as opposed to the current dealer-to-customer and dealer-to-client set up yields significant benefits, notably giving investors access to best execution, minimising the concentration of risk among too big to fail dealers as well as narrowing bid-ask spreads and increasing liquidity;
- **Financial transaction tax**: completely reconsidering the implications, including unintended consequences, of the implementation of a Financial Transaction Tax regime. The imposition of a Financial Transaction Tax would produce harmful effects to both the financial sector and the real economy. The introduction of new taxes will always result in financial institutions passing on the additional costs to end investors, and this would act as a barrier to accessing financial markets. It would also increase the cost of hedging, thus acting as a disincentive to manage risk, as well as restricting liquidity and increasing volatility in markets. A Financial Transaction Tax proposal is thus patently counter-productive to the aims of the Capital Markets Union and should be abandoned.

Fully realising a Capital Markets Union that is able to boast deep equity and debt capital markets across Europe would have a profound impact on economic growth in the region as well as allow for further and meaningful European integration. While much regulation post-crisis has already contributed toward progress with increased transparency and reduced interconnectedness, achieving the Commission's stated objectives poses a complex task. The points detailed in this letter* have aimed to emphasise potential barriers to the monetary and efficiency gains from deepening capital markets, and the expected impact on growth and jobs. We urge policymakers to generate an action plan to ensure that the current post-financial crisis regulatory framework in Europe is carefully calibrated and doesn't impede the effectiveness and efficacy of capital markets, including derivatives markets, and the ecosystem of market participants operating within them.

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*A detailed list of legislative amendments supporting the points raised in this letter is available upon request.