ADAPTING EU LEGISLATIVE PROCESSES

1. The European legislative process is not appropriate for developing competitive and efficient financial markets

1.1. The process is too slow and delivers complex frameworks

The moderator asked the panellists to discuss the weaknesses of the current EU legislative process before coming to some concrete proposals and whether this legislative process is adequate for dealing with innovation in the financial sector.

Indeed, the current EU legislative process is often criticised as being too slow in delivering, especially when it means a directive with its usual two-year transposition deadline. There are often too many detailed requirements put in level one legislation, which complicates further necessary changes. In other cases, too much leeway is given to national transposition of European directives, or too many national options are offered in Regulations: this creates a regulatory patchwork within the EU. Such shortcomings, which often result from an opaque negotiation process between the co legislators, limit the flexibility, agility, adaptability and proportionality of EU legislation. This is particularly detrimental in the financial sector, where it is essential to tackle ongoing substantive innovations and worldwide competition.

A regulator agreed with the current shortcomings in the legislative process. It does not keep up with the environmental and technological innovations. It would be notably useful if the European supervisory authorities (ESAs) could give an opinion on whether the existing financial legislation also applies to new innovations, because all too often there are grey areas and uncertainty between countries. It is important to have a consistent application of EU legislation in member countries. More cooperation is also needed with the ESAs and the legislators in developing an EU level approach.

1.1.1. Complexity of the process

An industry representative stressed that the current process in Europe is too slow because it is too complex. Level 1 texts should set out general principles. It would be beneficial if the legislators legislated, the regulators regulated, and the supervisors supervised. Everybody needs to stay within the remits of what their responsibilities and legitimacy are.

The balance between the European level and the member states is more political. The main reason for the split was subsidiarity, so what should be done at the European level is what cannot be done at the member state level. But the EU decision making process itself is not always straightforward, and can be affected by competing objectives of and even rivalries between the Commission, the co-legislators, the ESAs and supervisory authorities; this puts pressure at the European level to try to act fast, otherwise it is first come, first served. Moreover, Europe should try to find guidelines that should be set at the European level, and those that concern domestic targets, like in retail banking, could be done locally.

1.1.2. Reasons why the process is too slow

A regulator believed that the pace and efficiency of the legislative law making process is not fast enough anywhere in the world. The issues with the European process are exacerbated by the size of the market, the differences between local, national markets, and the number of stakeholders involved in the process. Europe should not struggle for the law to be ahead of reality; this will not work, especially in the field of innovation. The national legislators are naturally positioned to be quicker in their interactions with the markets. In fostering innovation, the floor should be given to national legislators in the areas of stability and customer protection.

1.1.3. Limitation of innovation as a result of the process

A regulator was not convinced that there is a split between the national and European level with regard to innovation. Regarding securities tokens, which could be a massive innovation in the future, it is not possible to develop them in the current European framework. It is clear that in some cases innovations can be developed on a national basis and then be proposed to be taken on board at the European level, but in some cases the European framework prevents innovation. There is therefore a need to bring some more flexibility to this case.

Regarding the EU level approach to innovation, a regulator stated that the European Securities and Markets Authority (ESMA) issued an opinion regarding crowdfunding in 2014, and the Level 1 text is not yet there. That means that many countries have drafted their own legislation. The ESAs should be given more powers; they cannot be given the powers of initiative, but they should be more vocal vis-à-vis the European institutions in assessing the need and priorities of legislation. Better interaction between level 1 and level 2 negotiations is also needed.

1.2. Subsidiarity should be promoted except with regard to financial stability and consumer protection

A regulator explained that EU legislation has its advantages over national laws mainly in terms of the safety of financial markets, especially in the areas of stability and consumer protection. This approach reduces the risk of unhealthy competition between member states which may be tempted to come up with solutions that do not provide sufficient protection of client interests and result in a regulatory arbitrage. A regulator also felt that Europe should go back to the subsidiarity principle that another speaker mentioned. The area of laws that are intended to foster innovation in the financial market or to enhance innovation in the market should be naturally left with member states as a general rule. One reason is that the member states' legislators and regulators are closer to the markets, so their reaction may be quicker. The timing at which they receive signals from the market or customers will be typically shorter and may be more responsive to the needs of the local market.

The local markets in the EU are still quite diversified in terms of the role of innovation. There are financial markets where the traditional, largest banking players are at the cutting edge of technology. That has an impact on the fintech industry and on the level of financial innovation. Room should be left for national legislators, but with the caveat that EU legislation should step in on matters like financial stability and customer protection; those are indeed the two areas where there is a clear risk of potential arbitrage or race to the bottom as part of competition arising between member states.

1.3. The Lamfalussy process remains fit for purpose

The panellists agreed that getting consensus for legislation that works for 28 countries takes time. The

Lamfalussy process remains fit for purpose but only if legislators and regulators are disciplined in how they apply it.

An industry representative stated that the European legislative process is one of the most interactive, stakeholder engaged legislative processes in the world. It is about getting consensus for legislation that works for 28 countries. It takes time to make sure all stakeholders have the opportunity to engage. Constant balancing is needed between the big picture objective and the detail that is required.

An industry representative added that in the immediate aftermath of the financial crisis there had been a tsunami of financial regulation, and people worked on many dossiers at the same time. When there are politicians in a room deciding something then the outcome will be different from having a group of regulators in a room putting together a structure on a technical competence basis. The Lamfalussy process works if it is adhered to; if the definitions of the levels are respected, then it could be made to work much more efficiently. Different pieces of legislation have had different outcomes; there will be blurring around the edges when it is a highly politicised file. There are some that are technical, such as the Central Securities Depositories Regulation (CSDR) and the Securities Financing Transactions Regulation (SFTR). Those two files were highly technical and there is much more of a division between levels one, two, three and four than there would be in MiFID, which is highly politicised and was a text not compromised.

An industry representative stated that European legislation has a great deal going for it, but the concern is that the European Parliament does such detailed levels of analysis that institutional memory is lost when people move off files. When the negotiating team changes, the question is who has the institutional memory to move that scrutiny forwards. Regarding CSDR and SFTR, it is uncertain how many current Committee on Economic and Monetary Affairs (ECON) members would know what it fundamentally addresses.

2. Proposals for improving the EU legislative process

2.1. Restoring discipline in the EU legislative process

2.1.1. Re-establishing a clear distinction between Level 1 and Level 2 will allow innovation to flourish

An industry representative believed that with so much detail now enshrined in Level 1, adapting rules as new technology emerges has become a slow and painful exercise, disadvantaging consumers and businesses. Lamfalussy set out a clear distinction between Level 1 legislation and Level 2 delegated acts and implementing measures, which remains the ideal model for financial services regulation. At Level 1 the co-legislators should set out the core principles, allowing the ESAs to develop the detailed rules at Level 2. Keeping such detail at Level 2 allows the regulatory bodies to respond more quickly to emerging market trends and risks, and to innovation and technological advance. Clear separation has rarely been maintained. It would be a good start to agree that no Level 1 legislation should include data, numbers, formulae or thresholds, or anything that requires calibration on an ongoing basis. If that rule is respected, then the supervisors and the ESAs would find it much easier to do their job based upon evidence and data.

A regulator stated that Europe can improve the legislative process. The deposit guarantee scheme is a good example; sometimes Europe harmonises technicalities but does not unify the underlying principles. That is the problem that can be identified in some of the pieces of European legislation; there is no political will or readiness, but for the sake of some sort of harmonisation technicalities are harmonised. This is not the optimal solution. The law making process could be amended and improved by following the original Lamfalussy principles more strictly than they are being followed after some years of development.

A regulator added that he fully agreed with the trend to strengthen the Level 3 tools that can be given to the supervisors or regulators as part of the accessibility and subsidiarity idea, which may bridge the gap between EU legislation and ensuring a minimum standard or minimum level playing field at the European level, while also leaving a reasonable leeway for national authorities to react or adjust in case such adjustment is needed for the greater good.

An industry representative believed that his company faces some challenges in the legislative process in Europe. An improved balance between the different levels of the legislative process is required. Next, we need to revisit the balance between Levels 1, 2, 3 and 4 to provide for robust long-term strategic principles at level 1, with the mass of technical detail filled in at a lower level to allow the EU to respond more flexibly to market innovations and global developments. UCITS is rightly recognised globally as the gold standard for investment funds – this is because the Level 1 text delivers a clear framework and parameters but with flexibility that allows different business models to compete and respond to evolving client needs.

2.1.2. Setting up impact studies systematically before the legislative process starts would improve the legislative process

An industry representative requested that the Commission should have more calls for evidence ahead of a draft legislation. There are issues in MiFID that the European Parliament struggled to find data on, and if they had asked for that data from the industry before the process started there might have been a better outcome.

It would also be beneficial to see true impact studies before the legislative process is started, and also during it, if there are significant changes being proposed during the process. Consistency checks, progress reports and interim monitoring of how the legislation is bedding in are needed. Where there are problems, an instrument is needed that allows people to go back in and fix it quickly. Sometimes a 'quick fix' is slipped into another dossier which has not been scrutinised by the stakeholders, and thus should be stopped.

2.1.3. Involving the ESAs in the trialogue is not an appropriate proposal

A speaker noted that trialogues are often not a pretty process, and some are better than others. The industry would recommend a developed, core set of principles on consumer engagement, and that those core principles should be used as a benchmark for reviewing the text.

An industry representative thought that it would be helpful for the ESAs to be present in Level 1 trialogues; they can be silent members, but they would get a granular feel for the interpretation that can help in terms of developing guidance.

A regulator noted that the trialogue is already very complicated to manage. There is a problem concerning the involvement of the ESAs at some point but putting them in the official trialogue process could be challenging, and to some extent everyone has to take responsibility for their actions at some point.

2.1.4. Members States should take a little more care about their last minute requests

An industry representative stated that when there is a highly politicised topic the Lamfalussy process becomes much

more blurred. Most of the things that cause issues tend to come from member states, very late in the day as red lines, and tend to disturb the entire balance of what has sometimes taken years of compromise. If people start fundamentally changing things at the very last minute and there are no regulators in the room to ask what the consequences are, then it is inevitably going to end up with a less precise piece of legislation. Member states should take more care about their last minute requests, because that often changes everything.

In the last decade much of the legislative agenda has come from outside Europe, such as the derivatives markets legislation. When the European Parliament tried to implement a global agenda within Europe; it always had to look to other regions around the world that were moving slightly quicker in their implementation than Europe, due to the latters very careful process. For subjects like market infrastructure legislation, much of those come from global bodies like the International Organization of Securities Commissions (IOSCO), so Europe needs to stay in line. If its infrastructure does not follow global standards, then it will be heavily criticised.

2.2. A much more holistic legislative strategy is needed

An industry expert explained that Europe needs a strong policy vision and a coherent narrative to develop capital markets in Europe and deliver long term benefits for Europe's citizen-savers. Europe needs to democratise investment, and it can do that by looking at the legislative approach and the sentiment that underpins that approach. There are numerous EU directives and regulations, which do not match the reality that consumers face. The legislation in Europe is a whole mass of individual products and services and today end-investors' needs are lost between myriad siloed products and service initiatives, which too often result in inconsistencies, contradictions and gaps.

For example, the same investment fund is required to show different transaction costs in different countries depending on how it is bought – which means end-investors lack a single point of authoritative information upon which to base their decisions. This creates frustration with the distributor and the end client. It also means that, as these are different pieces of legislation, policy focus is channelled into siloed and technical debates, each with their own dynamics and controversies. This diverts the attention of the policy world away from the core ambition, which is to get more retail investment into markets for their good and for the good of Europe.

The ambition must be that EU legislation is coherent for the end-investor across securities and prudential regulation, tax and accounting and the provision of investment products and services. Capital markets have a role to play in channelling investment into sustainable economy and infrastructure that can help productivity and innovative companies. From an asset management perspective, the US is a huge retail market and Europe is not. Most European consumers keep their money in deposits or in property, which impacts the productive and innovative capacity of the economy. Such a vision cannot be delivered without a far more holistic legislative strategy.

Regarding the intention underlying the investment, sometimes the approach seems dangerous and companies need to protect their consumers from investing. Consequently, it gets more technically detailed, with many complexities. If there is an examination of the Undertakings for the Collective Investment in Transferable Securities (UCITS), which was formed three decades ago, it is a really robust framework with principles and detail, which has stood the test of time, allows companies to compete, allows innovation to happen within it, and attracts capital from around the world. The European Long Term Investment Fund (ELTIF) is far more technical and complex; there are many fewer flows and tractions there.

2.3. European Supervisory Authorities should have the power to issue no action letters

A regulator stated that more powers should be given to the ESAs to issue no action letters. When some legislative provisions obviously cannot be applied, it is indeed key to have an emergency mechanism to suspend the application of the provisions concerned, in an exceptional and coordinated manner across member states. This would protect stakeholders from proceedings for non-compliance with these rules and would also help avoid major regulatory distortions vis-a-vis other countries, which is key in a globalized world. An illustration may be the second Payment Services Directive (PSD2) that is coming into force in a few days. Unfortunately, the preparedness for the required strong customer authentication is not yet there and a grace period resembling a no action letter is needed in applying it. If such a grace period is not granted, customers would suffer as they would be unable to use payment services. More generally, the ESAs and the Commission should work more closely together in order to enhance innovation in the EU. The interpretation of different member countries is different; it would mean an additional impediment to innovation to develop national regulation where the services are inherently cross border.

A regulator believed that no action letters could provide some security for the industry in some cases, but it would be more relevant if the Lamfalussy principles were strictly implemented, because there cannot be a no action letter targeting a Level 1 requirement. If the essence is in Level 1 and more is put in Level 2 then there is more room for a no action letter targeting only Level 2 issues.

2.4. Confidence must go hand in hand with a greater convergence of supervisory cultures

A regulator wondered if the principles should include a clear distinction between what is targeting retail and what is targeting wholesale.

An industry representative noted that that could be an option. Asset managers are nonetheless split, because on one side they want to see standardisation in capital markets, and on the other side they are very close to the end consumer and are embedded in their local markets. Behaviours can be changed if the supervisory coordination network focuses best practices and templates to try and build that upwards, combined with peer reviews and product intervention.

2.5. Is there a need for a European sandbox?

2.5.1. Certain conditions are essential for the proper functioning of sandboxes: equal access between all actors and a convergence of practices in each jurisdiction to avoid regulatory arbitrage

An industry representative stressed that competition is tough, which is seen in the trade wars between states. People should not be naïve and should make sure that the financial industry in Europe is able to withstand competition, including in terms of innovation. Sandboxes are one tool that organisations should not be shy of using but they have to be relatively small and used only for a short period of time. It should be very transparent as to how they are chosen and what the results of the test are. The tests must be done on a limited basis so that they do not have too many damaging consequences if they fail.

2.5.2. National legislation does not confer the right to passport services, consequently the markets potential for growth is limited

A regulator believed there is scepticism regarding sandboxes. The concern is that new entrants to the market

approach the regulator and think that sandboxes can help them avoid following the existing regulation. The question then becomes doing something within the parameters of not being illegal but being more of a limited period or number of users. It could be the case that that could be used on a cross border basis in the EU, but there are doubts as to whether one can export a company with a limited licence in the EU.

Another area where entering the European market is bothersome is the question of home and host supervision, and the obligations of the home supervisor, which should be amended in the legislation. If an entity applies for a licence in a country, then they should have to provide services in that country. They should not export services, because if an entity only exports services it might be that the home authority is not eager to supervise the services as the host authority. There are stories where companies have started to complain about why they were not accepted into the sandbox and their peers were. The ESAs and the European Central Bank (ECB) are currently investigating on sandboxes.

2.5.3. The EU strategy for innovation should not be a strategy for a sandbox per se but should rather be a comprehensive strategy for digital transformation; a pan-European toolbox is needed

A regulator noted that the sandbox issue is discussed in detail in some EU member states. The sandbox should not be seen as a universal tool. It is one of a variety and spectrum of potential tools that can be used as instruments that may foster innovation in the financial market. The sandbox itself is also a broad term; it is used as the name for very different setups that may be either legal, operational or marketing setups. A regulator explained that the EU should consider developing a separate EU regime for Fintech entities, but as an integral part of a more general strategy for the digital transformation of the economy, encompassing also matters like cybersecurity, AI or big data. The EU strategy for innovation should therefore not be a strategy for a sandbox, but should be a comprehensive strategy for digital transformation, with the fintech strategy being part of it. Within it there should be a spectrum of potential tools that can be used and reviewed by national regulators; a combination of these tools can then be adapted to the needs of the local market. A pan European toolbox is needed, with the sandbox being one of the tools in the toolbox that can be suggested to lawmakers who are interested in fostering innovation.

A regulator also stressed the importance of the choice of tools for fostering FinTech which should correspond to the characteristics of the local financial market and take into consideration the technological level of traditional banking business and the appetite for financial innovation demonstrated by 'traditional' financial entities. A regulator shared a regulator's views on the issues that Europe may face in connection with the cross border operation of early stage or low scale business entities. Countries may be tempted to encourage entities to incorporate in a given jurisdiction but without a real intention to do business there. Deposit guarantee schemes are also not fully integrated at the European level, meaning Europe may be facing the risk of countries licensing, regulating and guaranteeing the operations of entities where the real set of operations is being carried out elsewhere in the world.

A participant noted that rapid legislation has the possibility of encouraging errors. Close examination is needed of the unintended consequences of the legislation because they are often hidden in the numbers referred to. Sometimes these unintended consequences can be very severe. If their legislation is adopted, then only ESAs can give the right interpretation through questions and answers.

A regulator felt that balance is important between being able to react swiftly in a changing world and adapting the regulation accordingly and taking the adequate time to put the right framework in place.