September 2020

EU Capital Markets Recovery Package
Franco-German contribution

The French (FBF, AMAFI, AFPDB) and German (DSGV, DDV) associations welcome the opportunity to share their position to contribute to negotiations on the EU Capital Markets Recovery Package.

Overall, we are very supportive of the approach taken by the European Commission (EC) while nevertheless considering that on some specific issues reforms should go a step further to fully benefit to the financing of the Union's economic recovery. We also very much welcome this initiative in light of the growing probability of a hard Brexit and the EC's and co-legislators' ambitions to revamp the CMU project (i) to preserve the competitiveness of EU-27 financial markets actors and (ii) to develop the Union's sovereignty in the financing of its economy.

In this note, we highlight our main priorities for the MiFID II/MiFIR, Prospectus and Benchmark legislations. We remain at your disposal for any further detailed information which could be of use to facilitate progress in the negotiations.

1. MiFID II regulatory framework

1.1. MiFID II (Directive 2014/65)

- **Scope of the product governance regime's exemption**

While the alleviation of the product governance requirements for simple corporate bonds with make-whole clauses is a step in the right direction, we are wondering why the exclusion should be so narrow, considering that all ordinary shares and plain vanilla bonds issuance are similarly important for the financing of companies.

Other non-packaged/simple/plain vanilla instruments like shares or fixed rate bonds (i.e. all non PRIIPs products) should be exempted as well based on the following arguments i) these products are not produced to serve additional (retail) investors' needs and objectives or address particular risk profiles; ii) they are issued to raise capital which is urgently needed especially in context of a COVID 19 recovery; iii) the added value of product governance requirements for vanilla products is, in principle, very low or non existent in the primary market. Besides, the exemption should not be limited to certain corporate bonds as there is no justifiable reason to privilege corporate bonds towards bonds issued by banks.

This being said, the exemption of corporate bonds with make-whole clauses should be accompanied with the clarification that this category of bonds do not fall under the scope of the PRIIPs regulation (so that they would also benefit from the exemption under MiFID II). As these make-whole clauses have been qualified by the European Commission as "investor-protective features", they should be acknowledged under both MiFID II and PRIIPs.

In addition, we see as positive that no further distinction is introduced between complex or non-complex financial instruments. The dichotomy in MiFID II of complex versus non-complex financial instruments was created in order to allow for distribution in execution-only services and should not serve as a guiding principle to distinguish between different financial instruments.

As far as the UCITS are concerned (in case it would be contemplated to make them benefit from this exemption), it would be a fundamental change of the product governance regime which would imply a full review of the underlying objectives and is therefore incompatible with the purpose of the quick fix.

Furthermore the limitation of the exemption to execution-only situations would not have much practical relevance as these situations are very seldom in particular on German and France markets. However the application of the exemption to instruments sold exclusively to eligible counterparties would be welcome.

- ❖ Article 4(1) (50a) should be modified, as well as Articles 16(3) and 24(2) (a).

    ➔ In case the quick fix would not reach the scope, which we are recommending, the full MiFID review would be a good opportunity to contemplate further flexibility for the product governance regime, with the aim to have all non-structured (simple) bonds and shares excluded.

- ➢ **Scope of the exemption on cost transparency for eligible counterparties and professional clients**

We recall that under the new article 29(a)(1) MIFID "*the requirements laid down in point (c) of Article 24(4), shall not apply to other services provided to professional clients than investment advice and portfolio management*". According to article 50 of the MIFID Delegated Regulation, which sets out the content of information on costs and charges, information on inducements paid or received by the firm is a standard item of the costs and charges disclosure. This information on inducements will no longer be required to be communicated to professional clients and eligible counterparties as a result of the new article 29(a)(1) MIFID. However, article 24(9) MIFID still requires firms to disclose such inducements as part of the information to clients regime under MIFID II. For consistency purposes, we suggest to amend article 24(9) or 29(a)(1) to specify that information on inducements is due insofar as information on costs and charges is required to be given. The communication of inducements by firms to clients will, nevertheless, continue to apply pursuant to the conflicts of interest regime, as set out in article 23, which remains unchanged.

- ❖ Article 29a (1) should be adjusted.

- ➢ **Alleviation of cost benefit analysis in case of switching of financial instruments**

The provision which relates to the cost/benefits analysis of switching of financial instruments is welcome. However, the requirement to inform the client on the switch executed on his behalf does not correspond to the practical reality of the service of portfolio management. For this reason, we are of the opinion that the information requirement should be limited to investment advice.

- ❖ Article 25(2) should be amended.

- ➢ **Opt in for professional clients and future facilitation for retail clients**

The exemption of services provided to professional clients and eligible counterparties from the costs and charges requirements is very welcomed.

However, the possibility of *opting-in* offered to professional clients, which implies a case-by-case management of the relationship with said clients, will bring more procedural complexity and higher IT costs for banks while the purpose of the quick fix is to cut red tape generally. Therefore, it would be appropriate to remove the right to *opt-in* for professional clients in order to achieve the expected goals of the MiFID II quick fix initiative. Following this removal, the provisions of Article 29a (3) should be deleted.

We would also like to draw the attention of the EC to the fact that, with respect to Article 25(6), only the provisions of its first subparagraph can be concerned by the right to *opt-in* offered to professional clients. Indeed, the other provisions of this Article refer to suitability statements and suitability reports, both of which are only required for retail clients and should therefore not be affected by the opt-in right.

- ❖ Article 29a (2) should be amended and Article 29a (3) should be deleted.

  - ➔ As the next step, the situation of qualified retail clients should be addressed. Practical experience shows that many clients, including retail clients, show no interest in information on costs and charges within the meaning of Article 50(1) subparagraph 2 and 3 Delegated Regulation (EU) 2017/565. On the contrary the information overload may be detrimental to the feeling of having access to relevant information.

In this context facilitations for retail clients should be contemplated while using the possibilities offered by the existing regulatory toolkit. MiFID II already provides the possibility for experienced retail clients to be treated as professional clients and waive some of their protection, upon request and if they fulfill the conditions of Section II of Annex II of MiFID II. Consequently and in conjunction with the information overload described above, several avenues may be explored, in particular it might be worth testing whether the conditions for "opting-up" (from retail to professional) are to be changed. This may include redefining the threshold calculation base by taking more assets into consideration and modifying criteria related to the professional position of an individual.

- **Regime of SMEs research**

MiFID II/MiFIR has deeply modified the economic model of financial analysis for equity markets by *de facto* prohibiting the former and largely used "bundled model". Henceforth, research has to be paid by asset management companies independent of the transactions they carried out with their brokers.

There is a large consensus among issuers, asset management companies and research providers that, given the new rules, the total amount paid for research has dramatically diminished and will likely continue to fall in the coming years. So will the supply of research.

This diminution in the supply of research primarily impacts SMEs given the weakness of its economic model. MiFID II provisions should therefore be reviewed as a matter of urgency in order to, at least, introduce proportionality in the inducement regime for SMEs research (Article 24 (14) of Directive 2014/65/EU: "*The delegated acts referred to in paragraph 13 shall take into account: (…) (d) concerning investment research, the proportionality of the regime for SMEs.*").

The EC's proposal is a step in the right direction as it introduces for investment firms an optional bundling regime authorising the joint payment for execution services and investment research regarding (i) SMEs not exceeding a market capitalisation of EUR 1 billion during the 12 preceding months and (ii) fixed income instruments.

We believe that this measure will help having a wider research coverage for SMEs. However, we also consider this proposal as a first step towards a more in-depth revision of the unbundling regime regarding any types of investment research, including issuer sponsored research. Indeed, the latter is one of the tools at our disposal to stop the decline in research coverage for SMEs and should therefore be favoured provided that potential conflicts of interest are duly disclosed.

This being said, we consider that the EC's proposal should be reviewed in order to delete the amendment providing for the creation of Article 13(11) and therefore ask for the removal of the three cumulative conditions governing the "bundling" rule for SMEs with a market capitalisation of EUR 1 billion.

In fact, (i) the third condition provides no additional information in relation to what is already specified in Article 13(10), while (ii) the first two conditions considerably reduce, if not eliminate, the scope of the new Article 13(10) by framing its implementation in an extremely strict and complex manner for investment firms. Thus, instead of simplifying the environment relating to research, these two conditions impose on the contrary the implementation of new complex processes that are added to the existing constraints for issuers with a higher capitalisation.

In conclusion, we believe that the proposal goes in the right direction by introducing an optional bundling regime for SMEs. However, we believe that such proposal should be simplified, lowering the conditions imposed on such optional bundling regime, in order to alleviate the administrative burden to be complied with by financial intermediaries.

- ❖ Article 13(11) should be deleted.

➢ Best execution reports – extension to RTS 28

We welcome the fact that the EC suggests suspending the obligation of the trading venues to prepare RTS 27 reports (so-called (quarterly) quality of execution reports). However, we believe that also the obligation of the investment firms to draw up best execution reports under RTS 28 (report on the top five execution venues in terms of trading volumes and yearly report on the quality of execution) should also be suspended. Indeed, these reports are closely linked and the suspension of only the RTS 27 reports is not justifiable. In support of this statement, these best execution reports, in their current form, are not read by investors; there is a low number of downloads from the websites; therefore there is an assumption that investors cannot or do not make any meaningful comparisons between firms based on this data. Consequently, we are of the opinion that the same reasoning given by the EC for suspending RTS 27 reports should apply to the RTS 28 reports.

- ❖ Article 27(6) of Directive 2014/65/EU should be amended.

➢ Time implementation for phase out of the paper-based default method for communication

The proposal laid down in Article 24 paragraph 5a is very positive. In order to allow for an orderly and effective implementation, we would recommend foreseeing a voluntary timeframe for the implementation, for instance two years, as some investment firms will probably need to develop IT systems in order to be able to provide all (existing) clients with an electronic mailbox.

- ❖ Article 24 paragraph 5a inserted should be adjusted.

1.2. MiFIR (Regulation 600/2014) and Delegated Regulation 2017/565

➢ MiFIR - Trading obligations in a Brexit context (STO/DTO)

With less than 4 months to go before the end of the transition period set for Brexit and given the growing likelihood of a hard Brexit, the scope of the STO and DTO is a major source of concern for EU-27 investment firms. From 1 January 2021, UK trading venues will become third-country trading venues and are unlikely to benefit from an equivalence recognition before 31 December 2020.

In such context, one can expect the UK STO and DTO to overlap with those foreseen in MiFIR. The cumulative application of UK and EU laws would have a detrimental impact on the ability of EU-27 investors and intermediaries to transact on instruments subject to both EU and UK rules, and hence would damage the competitiveness of EU-27 entities without contributing to the protection of investors or the integrity of EU markets. Clarifying the scope of the trading obligations is hence of the utmost importance to ensure a level-playing field between EU-27 investment firms and their international competitors, and ultimately to protect the EU's sovereignty regarding the financing of its economy.

In order to avoid the negative consequences ensuing from the application of both EU and UK trading obligations after Brexit EU co-legislators should clarify in the quick fix the scope of the trading obligations. As recommended by ESMA in its recently issued report (MiFID II/MiFIR Review Report on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares), the scope of the STO should be limited to shares admitted to trading with an EEA ISIN, while trading on third-country venues should be deemed in compliance with the STO when undertaken in the third-country's domestic currency. Second, the co-legislators should clarify that, unless otherwise explicitly stated, MiFIR provisions are not intended to have extraterritorial effects, and that the EU STO/DTO should not apply to third country branches of EU-27 investment firms.

- ❖ Article 23(1) and Article 28(1) should be amended.

➢ Consistency with Delegated Regulation 2017/565

As the provisions of Article 54(11) of the Delegated Regulation have been moved up to Article 25(2) of Directive (EU) 2014/65 and considering the fact that the new Article 29a(2) of the same Directive provides that it no longer applies to professional clients, it has become necessary to delete Article 54(11) in order to ensure regulatory consistency. Otherwise, difficulties in implementing the new provisions of the Directive might arise, as the delegated regulation applies to all clients and not only to retail clients (+ professional clients in case of *opt-in* if it this right is maintained).

In addition, given the changes introduced to Articles 24(4) and 30 of MiFID II by its new Article 29a(1) regarding professional clients and eligible counterparties, the provisions of paragraphs 2 and 3 of Article 50(1) of the Delegated Regulation must be deleted as they are now inconsistent with those of the Directive.

- ❖ Article 50(1) subparagraphs 2 and 3 and Article 54(11) should be deleted.

2. Prospectus Regulation 2017/1129

➢ Right of withdrawal linked to a supplement: scope and means of communication

In accordance with a proposal laid down by the German Presidency in preparation for Council meetings, in order for the obligation of information related to the right of withdrawal in the case of a supplement to target the investors who would actually benefit from it, we would recommend to limit it to investors who purchased on advice by the intermediary. Indeed only this group of clients' needs assistance in exercising their right to withdraw acceptances.

In addition, for the sake of a lighter flow of communication for both sides, this obligation could be fulfilled by contacting them by electronic means. This possibility is justified due to the short period of time (contacting clients and withdrawal right as well) and appears to be in line with the logic of the Prospectus Regulation, which values the internet and thus electronic communication as medium of information.

Another aspect of the scope is the precision which should be given regarding the subscription period. The clarification that the initial period is relevant would make clear that issuances on the primary market (in subscription) are relevant for the information, not on the secondary market like buying the products via trading venues. Otherwise it may lead to the confusion that the offer period goes on during the trading on the venues (and so may last forever). It is precisely during this initial offer period that a close contact exists between issuers and intermediaries (this is not the case when the product is listed on a trading venue), which allows for an efficient and swift information of the investors.

- ❖ Article 23(3) should be amended.

➢ **Adjustment of threshold for frequent issuers**

In view of the current- and post-COVID-19-crisis era, small and midsized credit institutions should be provided with a stronger liquidity tool. An obvious and minimally invasive way would be to follow the EC proposal where the threshold should be raised from 75 to 150 million euros. It is important that this amendment is made without time limitation because the economic impact of the COVID crisis is not foreseeable for the moment.

❖ Article 1(4) (j) should be adjusted.

3. <u>Benchmarks Regulation 2016/1011</u>

We welcome the EC approach as it provides a lot of legal certainty and protection for the market participants, with a solution which is a good start both from a regulatory and technical perspective.

In more details, the decision to provide for the possibility to designate a statutory replacement rate for benchmarks, which cessation would result in a significant disruption in the functioning of financial markets in the Union (BMR statutory replacement) is positive.

We also welcome the proposed exemption for FX transactions. However, the proposal may be to narrow as the relevant recital appears to limit the scope to "non-deliverable currency forwards and swaps". A narrow interpretation would lead to exclude from this exemption many other types of FX-transactions which face the same challenges. In addition, institutions will have difficulties to clearly delineate between covered and non covered transactions. We therefore suggest a broader/wider definition in order to avoid such difficulties.

➔ In order to ensure the completion of the Benchmarks Regulation review, we would welcome further actions by the EC next year. This would allow to address several issues of importance to the market participants in connection with the Benchmark review such as the solutions to ensure the effectiveness of the ESMA benchmark register, and the extension of the powers of NCAs to permit the use of non-compliant benchmarks in legacy contracts even in cases where the authorization is withdrawn.

*The **Association française des marchés financiers (AMAFI)** is the trade organisation working at national, European and international levels to represent financial market participants in France. AMAFI has more than 150 members operating for their own account or for clients in equities, fixed-income, structured products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located.*

*The **Deutscher Derivate Verband** (DDV, German Derivatives Association) is the industry body which represents the 15 leading issuers of structured securities with a market share of more than 90 percent in Germany. Its work is supported by 17 sponsoring members, amongst which are exchanges and direct banks. Based in Berlin, Frankfurt and Brussels, the DDV has the mandate to elaborate self-regulatory standards such as the Fairness Code which is observed by the issuers with respect to the structuring, issuing, marketing and trading of structured products. Transparency and education of retail investors is at the heart of its mission. For more information, please consult www.derivateverband.de.*

*The **Deutscher Sparkassen- und Giroverband** (DSGV – German Savings Banks Association) is the umbrella organisation of the Sparkassen-Finanzgruppe (Savings Banks Finance Group). The organisation includes 376 savings banks, five Landesbank Groups, DekaBank, eight Landesbausparkassen, ten direct insurer groups of the savings banks, and many other financial service providers.*

*The **Fédération bancaire française** (FBF) has for mission to promote the banking and financial industry in France, Europe and around the world. It determines the profession's positions and makes proposals to public authorities and economic/financial authorities. FBF has 340 member banks including 115 foreign banks. Regardless of their size and status, credit institutions licensed as banks and the branch offices of credit institutions in the European Economic Area can, if they wish, become fully-fledged members of the FBF. The central bodies of cooperative or mutual banking groups are also fully-fledged members. The FBF is member of the European Banking Federation (EBF).*

*The **French association of the structured and listed retail investment products** (AFPDB) represents the interests of the main issuers of structured products that distributed in France. Their product range includes both exchange traded securitised derivative products, such as warrants, turbos and certificates, and structured products (e.g. EMTN) distributed through public offering or private placements. The AFPDB Legal and Regulatory Committee actively contributes to the marketplace reflections on work-streams concerning the showing and distribution of structured products. Industry workshops involving both manufacturers and distributors are periodically organized by the AFPDB. They contribute actively to industry proposals in areas such as the implementation of the main regulations, the investor education programs, the disclosure and communication of key product information to, respectively, distributors and final clients. Information, news and publications:* www.afpdb.org