Bundesverband der Wertpapierfirmen e.V.
Schillerstraße 20, 60313 Frankfurt/Main

European Commission
DG Financial Stability, Financial Services and Capital Markets Union
Unit C1 – Capital markets union
SPA2 03/071
1049 Brussels
Belgium

your reference

your message of

city_date
Frankfurt/Main, 13.05.2015

Public consultation on building a Capital Markets Union

Dear Sir, dear Madam,

the *Bundesverband der Wertpapierfirmen e.V.* (bwf)[1] is a trade association promoting the common professional interests of brokers, market specialists and other independent investment firms throughout Germany on a national and European level. In this capacity, we welcome the possibility to contribute our thoughts in the context of the public consultation on the proposed building of a Capital Markets Union.

Since bwf's views on the questions asked in the online questionnaire are very much in line with the comprehensive comments provided by our colleagues from the *Association for Financial Markets in Europe* (afme) and the *International Capital Market Association* (ICMA), we abstain from providing our own detailed answers to the questionnaire but instead express our emphatic support for the arguments pointed out by our colleagues.

However, we would like to highlight in this letter a few additional considerations which we think which are of particular importance from the perspective of our members and small and medium sized investment firms in general:

The *Bundesverband der Wertpapierfirmen e. V.* expressly welcomes the initiative by the European Commission to build a Capital Markets Union in order to increase the contribution of market based finance to the creation of jobs and the overall economic prosperity throughout the Union. We are also of the opinion that banking- and market base financing are not to be seen as mutual exclusive alternatives but should complement each other by providing an intelligent set of diversified financing channels for the real economy.

[1] bwf is listed on the EU Register of Interest Representatives (Transparency Register) under the ID 258694016925-01.

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However, in the light of a broad regulatory and/or market driven "deleveraging" of bank balance sheets as a result of the financial crisis and increased capital requirements, a stronger political focus on the strengthening and promotion of market driven financing which could fill the potential gap resulting from shrinking bank balance sheets becomes even more desirable and necessary.

Attractive and sustainable capital markets need a diverse "eco system" of variegated market structures and firms of different size and profile

bwf member firms are usually small and medium sized enterprises. Despite their limited size, they offer highly professional services in the wholesale securities market. Even during the most severe phases of the financial crisis they did continue to fulfill their function as reliable counterparties, providing services and market liquidity on a continuous and predictable basis. In less stressed or normal market conditions, small and medium sized financial institutions substantially contribute to the effectiveness and competitiveness of financial markets by their high level of flexibility, specialization and – taking into account their limited size – usually extremely sound capital ratios. In other words, midsized financial institutions not only play an important part with respect to the "division of labour" in the capital markets but from a regulatory point of view can also be seen as fulfilling an important function in terms of risk mitigation and avoidance of undesired levels of concentration.

However, there is also a certain regulatory dilemma: Since the early days of the implementation of the first "Basel Accord", the EU did apply regulatory and capital standards designed (and equally important calibrated[2]) for large internationally active banks not only to smaller credit institutions but also to investment firms which have never been in the focus of the Basel Committee. What was intended to create a "level playing field" in praxis often turned out to be de facto a substantial higher regulatory burden for smaller firms. Taking also into account the magnitude of additional regulatory requirements – partly but not solely as a result of the financial crisis – it is not exaggerated to state that the cost burden resulting directly or indirectly from regulation, has reached a level which might threaten the cost effectiveness and in the end the existence of small and mid-sized financial services providers. As a direct consequence, a smaller number of SME market-participants would result in a higher degree of concentration which also means an increased level of systemic risk.

Not to be mistaken, we strongly advocate high regulatory standards as a precondition for market stability and investor's trust. Nevertheless we kindly ask to give

[2] As a single practical example, we would like to remind of the operational-risk-charge which was introduced with Basel II. Since the various "quantitative impact studies" were based on typical bank balance sheets, the application of risk factors resulting from these calibrations to non-bank investment firms may lead to capital charges for operational risk which often exceed the target level defined on a Basel level in a grotesque way.

the aspects of proportionality and appropriateness of regulatory provisions adequate attention in the course of designing the groundwork for a sound and effective Capital Market Union. As mentioned before, a healthy financial markets “eco system” needs a diversity of firms of different size and profile, not only to provide for a greater investor’s choice but also to substantially contribute to market stability.

“Better regulation” requires an effective, balanced and coherent legal framework

It is not surprising and even understandable that in the aftermath of the financial crisis – which despite its strong amplitude well beyond the financial sector was not a “capital market crisis” but was trigger by a narrow range of OTC-products – numerous new regulatory initiatives were introduced and dealt with under high time pressure. Furthermore and also situatively understandable, the overall regulatory direction became more oriented towards “restricting” markets than towards making markets more efficient.

However, in order to be able to contribute effectively to economic growth, it needs a twofold political approach: sound regulation has to go hand in hand with measures of promotion a fair, growth-oriented, competitive environment. Rebuilding trust among investors and enabling investment firms to provide efficient and well-tailored services, are two coins of the same medal.

Again, not to be mistaken, it would be wrong to consider that as being part of the securities industry, our understanding of “better regulation” would necessarily translate into “less regulation”. E.g. we are clearly disappointed that the Commission recently withdraw the proposal for a recast of the investor compensation directive after no political consensus among member states could be reached over a several years period. We still think that we need – and it would clearly support the objective of a Capita Market Union – a better, more sustainable and more risk-oriented financed investor compensation framework on a stronger harmonized basis.

An effective Capital Market Union would also need a more coherent overall legal framework. Therefore, a high level of coordination among different policy areas is required. The most prominent example of an initiative clearly not coherent with the objectives of a CMU is the proposal for a financial transaction tax (FTT) in the course of “enhanced cooperation” of 11 member states.

Not only would such a tax increase the cost of capital, inhibit growth, further fragment the financial markets within the Union and making the EU as a region less attractive for investors, but it would also – at least in its current design – cause significant damage to the functioning of the capital market. Without complementing the intended exemption for “agent based intermediation” (whereby a transaction only should be taxed once along a chain of intermediaries acting as agents) by a comparable provision for “principle based intermediation”, it is foreseeable that the tax would render in particular market-making activities – which

play an essential part in terms of liquidity provision in large parts of the capital market[3] – economically unattractive[4]. Aside from sovereign- and corporate-bond markets, SME-issuers of stocks would be most severely affected from a market deterioration resulting from an FTT which does not provide for an exemption for market making activities.

Accordingly, the introduction of an FTT in 11 member states would be likely to undermine any intended benefits of a Capital Markets Union. Or to put it in a nutshell: As much as primary markets are dependent on sufficiently liquid secondary markets, a Capital Markets Union, to become effective, will be dependent on a (tax)environment which encourages the provision of liquidity instead of inhibiting it.

Yours sincerely,

Michael H. Sterzenbach
Secretary General

[3] It is expressly supported by recent EU legislation5 that *"market making activities play a crucial role in providing liquidity to markets"* and any impairment of the ability to perform such a function must *"have a significant adverse impact on the efficiency of the Union markets" (cf.* recital 26 of Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps)

[4] With a gross margin typically in the lower single digit bps region, there is simply no „buffer" left for market makers to absorb the proposed tax rate of 10 bps for very leg of the transaction.