WORLD FEDERATION OF EXCHANGES

Capital requirements / ‘advanced’ economies (treatment of equity in the trading book)

European Banking Authority Consultation on draft Regulatory Technical Standard (under Regulation 575/2013 [Capital Requirements Regulation II])

WFE response – 2nd July, 2021

Q1. Do you agree with the list provided in Article 1 or do you think that the EBA should propose an alternative list? In particular, do you think that there is a case for additional – or potentially all - EU/EEA countries to be added to the list? Please elaborate by providing technical evidence focusing on similarities and differences in risk across markets.

The WFE[1] believes that the list should be open to additions, now and in future. We do not believe there is a case to remove any jurisdiction from the Basel Committee on Banking Supervision (BCBS) list – nor are we are of any imminent likelihood that BCBS will do so. But we do believe there are likely to be grounds for including other countries.

The criteria for adding to the list should, as a matter of principle, be risk-based. Bucketing of countries on the basis of anything other than risk measures can introduce distorted incentives (as happened, in relation to credit risk, with the original Basel Accord of 1988). And any overly harsh designation of countries could easily turn into a self-fulfilling prophecy, by reducing the willingness of brokers to intermediate in those jurisdictions.

Moreover, given that any legislation (EU or otherwise) passed now could be relatively slow and challenging to change in future, while the Basel process could in principle deliver additions to the list relatively quickly and easily, it could be important to build in flexibility. (We note that the Basel treatment of equity allows for no national discretion, unlike the treatment of interest rate products, meaning it is already more rigid.)

Adding more countries to the list (subject to their meeting appropriate criteria) would mean that brokers with operations in any given country will better be able to serve the needs of investors outside that country, allowing those investors to benefit from its economic growth and to diversify portfolios.

In our view, the capital treatment of positions in equity matters more than ever, in the interests of avoiding over-reliance on banking channels. Markets-based finance provides a balance (hence, we would observe, the EU's own focus on CMU) and is both more inclusive (especially via collective investment) and more supportive of long-term financial provision for citizens. Measures that raise the cost of trading, on the other hand, also raise the cost of capital, reducing opportunities for issuers and investors alike.

While models recognition offers a possible 'way forward' for some individual market participants, the marketplace as a whole will always include those on a standardised approach, which should not unnecessarily penalise any country, whether in the EU or outside.

Q2. What are the metrics, sources, and other criteria that should be used for potentially defining alternative criteria on which a list of advanced economies could be based? Please elaborate considering the context in which this definition this will be applied, i.e. assigning a lower/higher risk weight for equity risk.

The rules should allow for additions to the list, and should be based on clear criteria that are relevant to the asset class (ie, equity) – not on tangential measures such as the general economic development of the country (eg, GDP) or its creditworthiness (eg, sovereign credit rating).

We would suggest that liquidity and volatility could be compared to an international benchmark, such as a global stock index. At the same time, the practical reality is that some countries will enjoy the benefits of being on the BCBS

[1] The WFE is the industry group for exchanges and clearing houses (CCPs) around the world. We represent over 250 market infrastructures, ranging from those in the largest financial centres to frontier markets. WFE exchanges are home to over 47,000 listed companies, whose aggregate market capitalisation is over $100 trillion.

list, while others not on the list may have even better liquidity and even lower volatility. Accordingly, treating the BCBS as a baseline against which to compare could also be relevant.

The WFE stands ready to assist in refinement of the methodology and the provision of data, should that be helpful.

Q3. Do you think that there are markets of other countries that are characterised by a higher liquidity and lower volatility if compared to those included in Article 1, which as such should not trigger a higher risk-weight if compared to those of the countries listed in Article 1? Please elaborate providing evidence.

We agree that the measures proposed are relevant, in that they provide objective, risk-based criteria for adding countries to the list.

The key issue – as with other instances of cross-border arrangements, such as recognition of third-country CCPs – is that criteria should be reasonable, clear and transparent and should offer sufficient predictability that businesses can make plans.

We also believe that the regime should take into account liquidity in all shares that are listed in the country in question, even if some of them are also listed elsewhere. While any primary listing is likely to be in the jurisdiction where the issuer company is most active economically, this will not necessarily always be the case and the regime should allow for the possibility that it is not.