•SwissBanking

SBA response to the Commission's Green Paper on the Capital Markets Union

Introduction

Below you will find responses from the Swiss Bankers Association (SBA) to some of the questions in the Green paper on the Capital Markets Union (CMU).

Our overarching goal is to stress the importance of open markets and the need to improve economic conditions sustainably in order to attract increased capital inflows from outside the EU. As a global centre for wealth management, Switzerland could contribute considerably to the success of the CMU. This line of reasoning arises in part from the findings of a study recently published by the Swiss Finance Council. [1]

The Commission must ensure a level-playing field for all actors in financial markets, and there should be equal terms for all market participants. To ensure an effective Single Market it is necessary to align regulation to ensure that it does not act to prevent cross-border activity or to distort competition.

The consultation is structured by means of 32 specific questions raised by the Commission. Within this predefined structure, we limit our answers to questions 1, 17, 21 and 22, which all address major cross-border and international aspects of the planned CMU.

* * *

Consultation responses

1) Beyond the five priority areas identified for short term action, what other areas should be prioritised?

We agree with all five areas listed[2] in the Green Paper for short term action; we also see four further areas where we believe urgent action is required:

a) Better regulation in financial services

SBA welcomes the introduction of the new post of First Vice-President in charge of Better Regulation. The Capital Markets Union project should be based on robust principles of better regulation. In that sense we deem it appropriate to identify better regulation agenda as both a shorter and a longer term action. We also note that the Commission REFIT-programme (the Commission's Regulatory Fitness and Performance programme) is an important part exercise to reduce excessive administrative burden. This programme should be extended to financial services.

b) Simultaneously strengthening traditional bank financing

The green paper underestimates the ongoing importance of banks in financing the economy. The green paper refers to funding conditions in the US and the assumed decline in the ability of the European banking system to extend loans as a result of regulation passed in the wake of the financial crisis. This gives the impression that the Commission perceives

[1] The Swiss Finance Council: The EU & its Partners: Defending Open Markets in Challenging Times; February 2015; http://www.swissfinancecouncil.org/en/studies

[2] 1. Lowering barriers to accessing capital markets, 2. widening the investor base for SMEs. 3. Building sustainable securitisation, 4. boosting long term investment, 5. developing European private placement markets.

the interaction between banks and the capital market as a sort of zero-sum game in which the role of capital markets is to compensate for banks' reduced lending capacity. There is no reason for this perception. It should, instead, be assumed that capital markets and banks are complementary elements of the overall financing structure. SBA believes that banks have an important role to play for the CMU to succeed and ultimately for the EU to reach its growth objectives.

c) Creation of a single generic EU-recognition framework for assessing EU equivalence of third countries

Some financial centres, such as Switzerland are and will remain a regular "customer" of the ESAs in the assessment of the EU equivalence of third countries. In the foreseeable future, the ESAs could be assessing the EU equivalence of Swiss financial legislation with more than a dozen planned and/or existing EU directives.

It is in the interest interests of both the EU and major third countries that equivalence between a considerable number of relevant EU and foreign legislations be achieved reliably, predictably and within a reasonable period of time. This would improve legal certainty, reliability and confidences for all commercial parties involved in cross-border business, and thus establish an indispensable condition for capital markets by means of which to more readily attract capital and investments to the EU area.

As an immediate action a re-designed, well-structured, generic framework could help to streamline the at times complex but recurring processes of assessing equivalence. Such a new process is already enshrined in a number of existing directives and regulations but should be taken up consistently. In fact, we believe that such a predefined structure, together with stipulated core principles for material requirements, would greatly facilitate the ESAs' demanding tasks. In particular, this would enable the ESAs to conclude their assessments in a timely, transparent and resource-efficient manner, without sacrificing thoroughness or eliminating the Commission's prerogative to rule conclusively.

On the other hand, for a third country subject to assessment, such a generic process would ensure that the content-related requirements are more transparent and reliable (entitlement) and the process itself is more readily assessable (legal certainty).

Such a general process could be easily and rapidly established (low hanging fruit), by taking into account existing experience and principles of mutual regulatory recognition.

Likewise, an outcome-based, rather than a line-by-line approach (aimed at evaluating whether the third country regime achieves the same regulatory objectives as the corresponding piece of EU legislation for files like EMIR, AIFMD or MiFID II/ MIFIR), with consulting with the third country and its regulator prior and throughout the equivalence assessment process would contribute significantly to an efficient equivalence assessment.

d) Adjustment of current client classification under MiFID II / MiFIR

A range of different types of private investors are classified as retail clients under MiFID II, regardless of their investable assets, their risk appetite and their diversification needs (including geographically). This provision was adopted consciously, with the aim of securing maximum certainty for all private clients. Yet, in our view, practical experience demonstrates that whenever entirely different types of clients and client needs are subsumed in an undifferentiated manner, this can easily lead to inappropriate regulation for all affected parties and not desirable consequences and barriers for capital markets: Smaller retail

clients need more accessible investment information and have higher consumer protection requirements, while largely experienced retail clients with assets suitable and requiring for diversification and with interests in capital markets investments (including across borders) and corresponding risk appetite may demand more complex products.

The current categorization of customers under MiFID II, coupled with the distinction between complex and non-complex financial instruments, bar all retail clients from investing in certain securitized and structured products. This unjustly limits the investment opportunities available to wealthier private customers and will prevent them to invest in infrastructure projects etc.

All these restrictions affecting experienced clients clearly go against the CMU objectives of improving access to financing, increasing cross-border investment, and fostering connections with global capital markets. Consideration should thus be given to reviewing (1) the broad and catch-all class of 'Retail Clients'; (2) the unduly high and inflexible thresholds for undertakings to be classified as professional clients; (3) the conditions to benefit from the elective professional status; , and (4) the treatment of elective professionals under the MIFID II third country regime. Doing so will enable these experienced high risk-bearing investors to contribute to the success of the CMU.

This could also help to achieve the stated goal of widening the investor base for SMEs within the EU, as assets under management at banks in a third country would thereby become more readily available for investment in the EU (see also response to question 22).

17) How can cross-border retail participation in UCITS be increased?

Preliminary remark: UCITS is only one part of the overall picture of retail investment funds. Non-UCITS (i.e. AIFs) are also of major importance for retail investors in Europe.

We agree with the Green Paper statement (page 17), that the regulatory cost of setting up funds and the barriers to becoming authorised managers and selling funds cross-border creates disincentives for both investors in and issuers of investment funds in the EU. Reducing these barriers would encourage new market entries and/or thereby increase the range of UCITS and non-UCITS products available in the market, giving consumers more choice to invest part of their savings in structured debt, securitized products or investment funds. In order for this to happen, it is imperative to regain the trust of the wider public and of consumers in financial markets in general, inter alia by enhancing “intelligent” consumer and investor protection. What do we mean by that?

(i) A reform of the national implementation of EU directives is necessary in order to bring harmonisation, and thus predictability, across Europe with regard to financial market regulation. Too often, EU member states either gold-plate EU directives or in contrast, delay implementation, which threatens the idea of a European single market.

(ii) Move away from creating ever-new and additional legislation and toward enhancing the quality of supervision of existing rules: The financial services sector has seen a major update of all its fundamental regulation in the last few years. It is now important to implement these new rules properly and to collect some empirical evidence as to their effectiveness. No major new legislation should be introduced.

21) Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

Capital markets in the EU need to be globally competitive to attract investments from elsewhere. This needs to be taken into account when new measures are being considered within the EU. New initiatives should be proportional and should be consistent across the EU and internationally. Additionally, the SBA would like to underline that third country equivalence could contributes to the competitiveness of EU capital markets.

Generally, from the perspective of an investor from a third country, the attractiveness of the EU depends largely from the availability and well-functioning of a proper EU-passporting system for financial services. Passporting rights only apply within the EEA. Although Switzerland is not an EEA State, Swiss firms have the right to set up an establishment in the EEA under the provisions of special bilateral treaties between the European Union and Switzerland.

22) What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?

The CMU embraces major international and cross-border aspects as the Green Paper correctly acknowledges: “Given the global nature of capital markets, it is important that the CMU is developed taking into account the wider global context.” (p. 20).

Open markets and multilateral cooperation are essential

Open markets and multilateral cooperation have been central in Europe’s post-war economic framework. This openness has underpinned its economic growth, enhanced its economic development, and has served as an important ‘shock absorber’, not least during the global financial crisis. Free trade and close collaboration are not outdated principles. Ample historic evidence impressively reflects the fact that both principles have served Europe well for many years. They deserve to be upheld and even reinforced in light of recent events.

Europe’s still-nascent capital markets

The inception of the CMU is a welcome opportunity to further strengthen the Single Market. Europe’s capital markets are still fragmented. Europe’s challenge involves more than creating alternatives to bank lending to fund the recovery. It needs to make the structure of the financial system more competitive and efficient – and ultimately more growth-friendly. This is an area with huge development potential. Had Europe’s capital market issuance between 2009 and 2014 been similar to the United States’ as a proportion of GDP, it would have been more than double its actual size, i.e. €9 trillion instead of €4 trillion. It has to be noted, however, that one of the reasons for the differences in the US and EU capital market financing is the inherently different culture for financing in the US which means that the US model does not lend itself to be fully replicated but should rather serve as a basis for a greater understanding of the necessary steps for achieving a higher degree of acceptance of EU capital markets for investors, in particular non-professional ones. More specifically, we believe the EU ambition level must reflect that certain markets in the US, such as securitization, have been highly dependent on state support. From our perspective, we believe additional state support would go in the wrong direction and would be counterproductive in meeting the CMU objectives. But this means that the EU ambition level must be calibrated accordingly.

With their foreign direct investment (FDI) and technical expertise, non-EU countries can contribute their share to the success of the future CMU. In an even broader view, it is our conviction that successfully developing and implementing both the Banking Union and CMU can be achieved more readily and probably in conjunction with strong and competent third country partners; to the mutual benefit of all those involved. Key to this is the removal of the remaining barriers and ensuring fair access and equal treatment of international investors.

We would therefore encourage the responsible EU authorities to consider all measures that help to ensure that the benefits from economic cooperation with key partners can still be reaped in future. In particular, attracting capital inflows and investment from within *and* from outside the EU to support the real economy, and particularly SMEs, were and remain a key strength that should be preserved and strengthened.

With regard to funding for SMEs we also believe that there is a high risk that the proposed the new MiFID II Level 2 framework for payment for investment research will further reduce the availability of information on SMEs and consequently reduce the willingness of capital market investors to provide funding to SMEs. Non-bank investors currently lack information on SMEs which materially undermines their willingness to invest. Investors cannot be expected to invest in products they don't understand. Investment research can play a crucial role in providing such information. It is therefore essential that a proportionate approach is taken under MiFID II that appropriately balances investor protection with the availability of research across all types of firm.

Attracting capital flows and investment from within and outside the EU
One method of choice recommended in the Green Paper is that direct marketing of EU investment funds and other investment instruments in third countries should be facilitated. The Commission is interested in views on measures that could be taken to increase the attractiveness of EU markets to international investors.

We believe it is worthwhile to also look at the issue from a third country perspective: At the end of 2014, banks in Switzerland managed roughly € 2.5 trillion in securities with foreign beneficial owners (Swiss National Bank), compared to total cross-border portfolio investments between EU member states of €9.6 trillion and portfolio investments coming from outside the EU of €5 trillion (IMF). Most of these assets under management, pooled at banks in Switzerland, are invested globally and well-diversified around the globe, including in some EU member states.

What measures can be taken at the EU-level to facilitate the ability of third country financial intermediaries to invest a growing part of their pooled assets in the EU? Basically, there are two ways to unlock more investment for EU companies and attract increased investment from outside the EU:

a) to increase the chances of assets pooled and managed outside the EU of being invested in the EU (e.g. due to the need for diversification), for instance through sizeable EU-wide investment funds and,
b) to enhance the possibilities that such funds (for instance UCITS) are marketed successfully and globally to all customer segments, including to EU-citizens by means of cross-border sales from outside the EU.

Sustainably improve general economic conditions
In order for this to happen, it is of fundamental significance that not only the numerous CMU-related issues are appropriately regulated but, but that in addition, general economic

conditions and the future prospects of EU member states be sustainably improved. The most decisive single factor by far for maintaining and increasing the attractiveness of EU markets for international investors is the expected forthcoming investment performance. Only if and when these prospects can be successfully improved, will the CMU have a fair chance at competing with other major capital markets for investment opportunities, and thereby attract capital from third countries.

Contact email address: stefan.hoffmann@sba.ch

* * *

The above responses were submitted to the EU-Commission on 11th May 2015.

Next Steps

European Commission

CMU Hearing	8 June 2015 in Brussels
CMU Action Plan	expected September 2015

European Council

The June EcoFin will set Council's priorities on the file. The rotating Council Presidency will be held by Luxembourg, who shares the CMU objectives and are ready to work on the file from Sept. / Oct., as the COM releases legislative texts. Securitisation and Review of Prospectus will come first - both receiving priority status from LUX Presidency.