SwissFinanceCouncil
Fostering International Dialogue

SFC Position on Future of CMU

The Swiss Finance Council (SFC) engages in dialogue around policy developments in finance at a European level. Our members, including among the largest global asset and wealth management firms, have substantial activities within the EU.

We welcome the public reflection on the future of the EU Capital Markets Union (CMU) project. We believe that a particular focus should be given on measures that can bring more size into the EU capital market in the short and medium term, as necessary to fund and guide financing of the twin green and digital transition. Against that backdrop, we have set out our initial policy recommendations.

1. Revitalising the EU securitisation market

The EU securitisation market was disrupted as a consequence of the 2008 Global Financial Crisis (GFC) and remains limited in size compared to the US market despite, post-GFC, very resilient credit performance with a low level of losses and defaults. In the 15 years since the GFC, securitisation in Europe has barely grown at all. EU issuance was equal to 0.3% of EU GDP (EUR 53bn) in 2022 compared to US issuance (EUR 2tn) at 1.4% of GDP and issuance in China at 1.8% of GDP.

The lack of recovery in EU securitisation market post-crisis has resulted in EU banks being constrained in managing their balance sheets, limiting their financing capacity and reducing the range of financial instruments available for investors to build well-diversified investment strategies, while acting as a break on the development of EU capital markets.

As noted by ECB President Lagarde[1], an appropriately scaled, regulated and supervised EU securitisation market could act as an effective funding and risk transfer tool for banks. By augmenting capacity in the banking sector, it could enable a more diversified set of investors to fund EU corporates and support the economic, green and digital transition.

The GFC highlighted the need for simpler, more transparent and better supervised securitised products with less embedded leverage. The EU STS framework for securitisation promotes high quality securitisations, with eligibility criteria that exclude the riskier types of securitisation that were the source of most of the losses during the GFC. However, STS issuance has been held back as these high standards are not fully reflected in the current capital and liquidity treatment of STS securitisations.

The EU and international securitisation framework needs to be reviewed, building on recent adjustments. Of utmost importance is to recalibrate the prudential treatment of securitisation exposures to reflect their high quality, to unlock its potential as a powerful risk transfer and financing tool and encourage the development of a sustainable securitisation market at scale. Other aspect of the rules, including the highly complex criteria to qualify as STS, the Significant Risk Transfer assessment process and disclosure and due diligence requirements, would also benefit from greater proportionality and simplification.

2. Broadening the investor base for capital market products

Success in the Capital Markets Union and the EU Retail Investment Strategy rests on investors being able to invest in a way that suits their needs. We believe that increasing retail investor participation in EU capital markets is central to deepening those markets and offering alternative means to fund companies, including smaller firms that want to grow. According to New Financial, EU households keep a third of their financial assets in cash, and increasing their asset allocation to investments in stocks,

[1] [A Kantian shift for the capital markets union (europa.eu)]

bonds or funded pensions by just five percentage points would unlock an extra EUR 1.8tn (11% of EU GDP) that could support investment, jobs and growth. EU initiatives can be complemented by Member States using their domestic levers in terms of financial education or taxation to encourage retail investor participation in capital markets. Financial education in particular would be a powerful tool to empower citizens, but its impact on deepening capital markets would only emerge over time.

In addition, many sophisticated investors in the EU, who can make an immediate contribution to deepening of EU capital markets, are currently unable to access Alternative Investment Funds such as private equity and ESG funds because of the design of MiFID client classification rules, which currently focus to a significant extent on frequent trading as a proxy for sophistication. The EU Retail Investment Package contains welcome amendments aimed at giving sophisticated investors that have both a good understanding of capital markets and means to bear losses the option to be treated as professional investors. However, we would welcome further changes to confirm the move away from transaction frequency and knowledge about distinct asset classes to a broader understanding of capital market products and the investment landscape. This is important to ensure that the Retail Investment package fully achieves its goal of broadening investment options for sophisticated clients while also broadening the investor base for the CMU.

3. Allowing third country jurisdictions and firms to opt into the CMU

Increasing the scale of the CMU requires not just deepening and integrating capital markets but also attracting external capital into the EU. This can be achieved by opening the CMU to certain jurisdictions, institutions, or capital flows. Allowing an opt into the CMU would increase the EU's capital market financing capacity and reduce critical dependencies from jurisdictions with values and policies that contrast with the ones of the EU.

In designing such a regime, consideration could be given to attracting capital from jurisdictions with shared geopolitical and economic objectives, high compliance with global regulatory (prudential) standards and robust supervisory frameworks. Closely associating the Swiss capital market with the CMU is a logical starting point and would not only increase the offer of capital market products in the EU, but more importantly help financing the twin green and digital transition in the EU.

4. Establishing an EU regulatory framework for transition finance

The EU will need additional investments of EUR 700bn annually to meet the objectives of the Green Deal, which highlights the importance of capital markets in helping finance the green transition. While the building blocks of the EU sustainable finance framework are now in the process of implementation, we support a focus under the Sustainable Finance Reporting Directive on ensuring international alignment of product disclosure standards to facilitate cross-border investment in sustainable economic activities.

We would also welcome further EU and Member States' guidance and measures to incentivise individual corporates and sectors to accelerate their net zero transition pathways, starting with the highest emitting sectors. This would be instructive for financial firms' own transition plans, while we believe international alignment and standardisation of transition plans is key to facilitate their application and foster their credibility.