The EU and its Partners:

Defending Open Markets in Challenging Times

SwissFinanceCouncil
Fostering International Dialogue

Europe: Challenges after seven years of crisis

- Weak GDP growth, with large divergences within the EU/Eurozone
- Subdued inflation, currently negative
- Excessive public and private sector debt, slow deleveraging
- Structurally high unemployment
- Growing support for anti-establishment parties:

  => Europe is facing economic, social, and political challenges

  => <u>EU</u>: Long-term economic and political success is at risk

  => <u>Euro area</u>: Integrity of monetary union is at risk

Banking Union – a major step forward

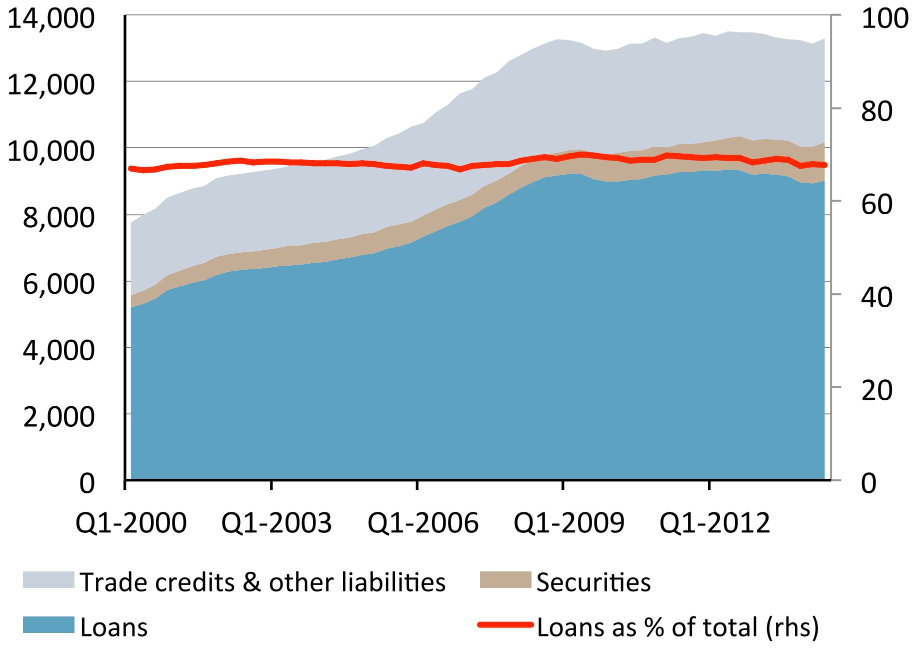
- Financial crisis & sovereign debt crisis have hit EU banking sector hard
- Weak banking sector has caused major damage to the economy
  - Banks are a key source of corporate funding in Europe (unlike the US)
  - SMEs, the backbone of the EU economy, have suffered particularly badly
- <u>Banking Union</u> to break the vicious circle between banks & sovereigns
- Asset Quality Review and Stress Test, followed by recapitalisation
- Single Supervisory Mechanism (4 November 2014)
- Resolution Mechanism and Resolution Fund to follow in 2016
- Major step towards healing of the Eurozone banking system

The next big thing: Capital Market Union

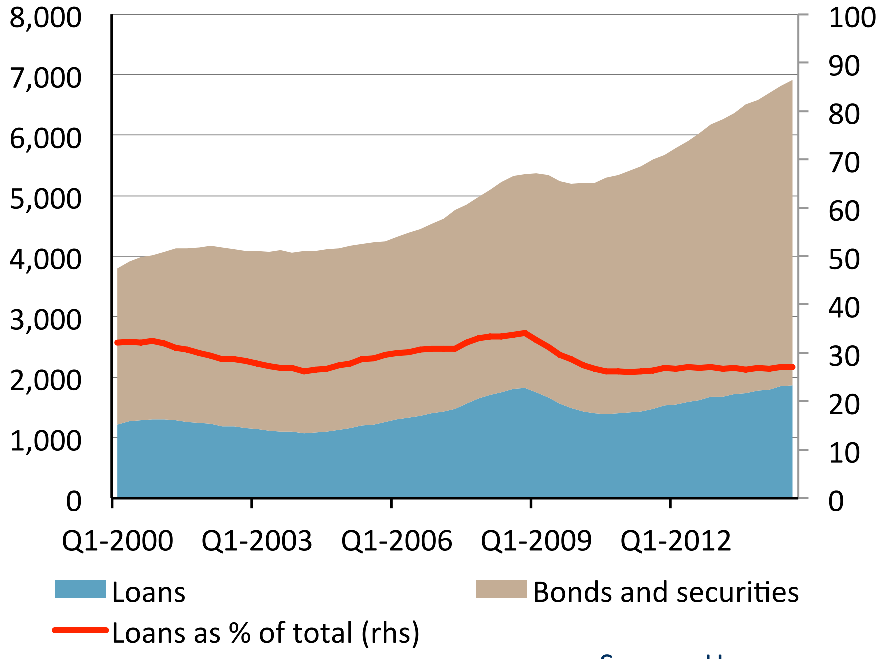
The aim of the Capital Markets Union (CMU)

1. Alternatives to bank funding, focus on securities markets
2. More efficient, growth-friendly and fully integrated financial system
   - European capital markets remain fragmented along national borders

Corporate borrowing in the Eurozone, €bn



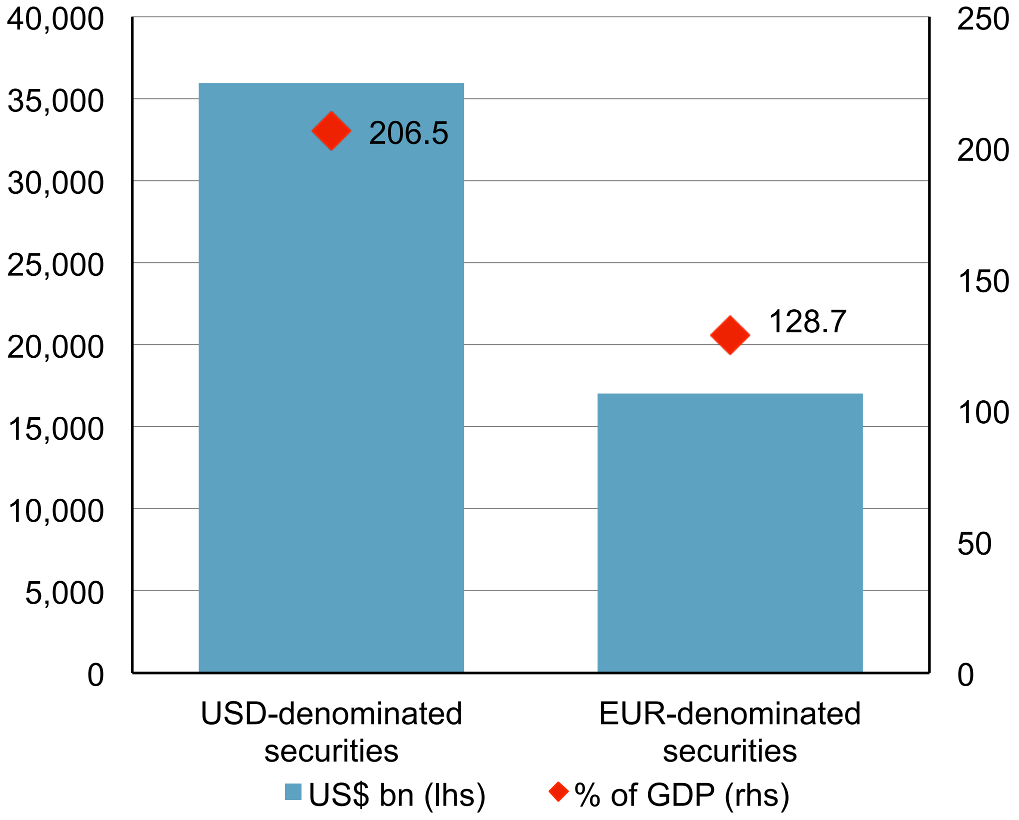
Corporate borrowing in the US, $bn



Source: Haver

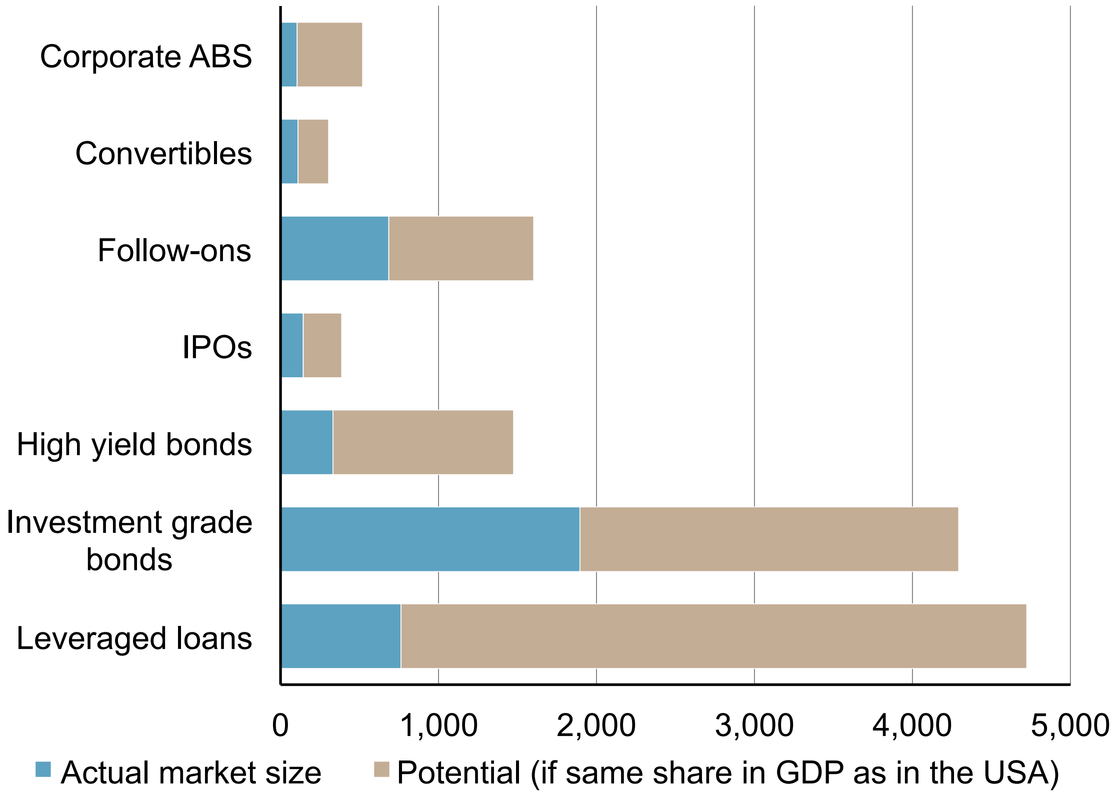
The upside of truly integrated capital markets

Securities markets are much bigger in the US than in Europe



Source: Markit, iBoxx, SIFMA, SFC

European new issuance vs its potential (if same size relative to GDP as in the US) €bn*

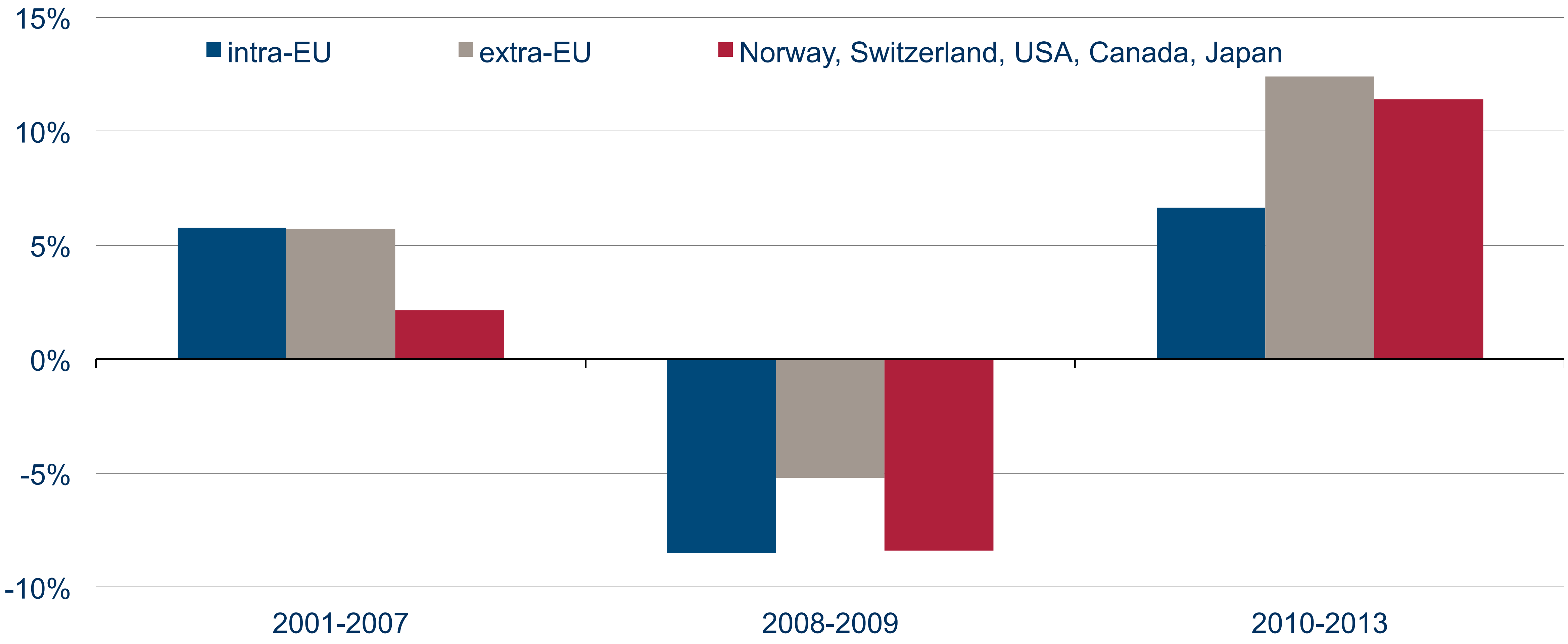


Source: Wright, W. (2014), Dealogic, National Statistical Offices, SFC

* 2009-2014 Europe includes the EU, Switzerland, Norway and Iceland

External trade as an EU business cycle stabilizer

Growth of trade (exports) intra- and extra-EU, annual averages



Source: Eurostat (2013)

Non-EU partners can play a vital role in the region's recovery and development

- Efficient and robust markets, both within the EU and beyond, are needed for Europe's economy to thrive
  - The Banking Union (BU) will contribute importantly to this process as it develops into a common approach across the major economies
- Capital Markets Union (CMU) offers the opportunity to open up other, non-bank sources of saving, both to finance investment and thereby increase the region's resilience to shocks
  - It is best conceived, developed and implemented in conjunction with key partner economies
- Europe's external partners contribute significantly to EU economic activity and welfare, bringing both direct and indirect benefits through trade, finance and employment
- A small number of countries are disproportionately important
  - The top three non-EU destinations for EU goods and services are the USA, Switzerland, and China
  - One-third of EU countries' FDI comes from outside the EU, with Switzerland and the USA at the fore

CMU's key principles and challenges

What is new:

- The Commission believes that the case for a Capital Market Union now is obvious despite the fact that the EU has been trying to create a capital single market for a long time!
- There is a new focus on incentives for demand (i.e. investors) whereas in the past, the Commission focused primarily on the regulation of banks.
- There is a fresh awareness that 'one size does not fit all' and that the US capital market is not necessarily the benchmark for an EU capital market.
- The Commission somewhat reluctantly admits that some of its previous regulations were counterproductive in terms of growth and access to bank loans and capital.
- The Commission is ready to look at new ways of achieving its objectives such as working with the industry (ex. private placement, market-led development of 'green bonds' standardisation) and working with the Member States (to tackle the Giovannini barriers).

CMU – The key questions

Some of the key questions that we should discuss:

- Diagnosis - do we agree with the Commission on what needs to be fixed and why? What is the problem?
- Solutions: do we agree with the Commission on how to fix the problem?
- Ownership - who owns the project ?
- The method - did we use the wrong methods in the past (i.e. we obliged the Member States rather than cooperating with them)?
- What will be the scope? What is the perimeter? What is the level of granularity of our standards and how will they fit in with the rest of the world?

Recommendation #1
Promote open and transparent markets!

➢At EU level

- Complete the internal market
- Focus on effective and consistent implementation of single rule book by ESAs
- Assess impact of new regulations on capital market flows inside and outside the EU

➢At international level

- Seek ambitious trade deals with key partners - especially with the US in the context of TTIP
- Encourage internationally recognized standards, implement them effectively and consistently as was the case for the OECD standard on Automatic Exchange of information in tax matters
- Support work by IOSCO, OECD and Basel Committee and stick to agreed standards

Recommendation #2
Policies should deliver both growth and stability!

➢At EU level

- Minimize differences between Euro-zone and non Eurozone countries when implementing the Banking Union
- Adopt a cooperative approach, to avoid risk of fragmentation within the EU

➢At international level

- Promote cross-border capital flows, collateral use and lending
- Promote regulatory coherence based on the lessons from EMIR & Dodd-Frank etc.
- When revising CRD, address discrepancies between EU rules and global standards

Recommendation #3
Capital Market Union can become a game changer!

➢ **At EU level – focus on European debt and equity markets**

- Encourage transparent securitisation, recalibrate ABS treatment in CRD & streamline existing reporting requirements; consider public guarantees to stimulate SME securitisation markets
- Review Solvency II could incentivise long-term investments into infrastructures projects
- Develop a Pan European MTF market for SMEs

➢ **At international level - enable long-term investors to fund the economy**

- Encourage international investment in private placement through harmonised EU framework
- Avoid geographical bias (i.e. EU focused only) when designing of funding vehicles
- Use European Fund for Strategic Investments to make international investments in infrastructures attractive