“FROM MiFID TO THE CAPITAL MARKET UNION – THIRD COUNTRIES PERSPECTIVE”

Happy Swiss Hour

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2007 - MiFID I (MiFID for beginners!)

- The 2007 Markets in Financial Instruments Directive (MiFID I) harmonized trading of securities across the EU and gave companies a “passport” to operate throughout the EU.
- MiFID broke the monopoly of stock exchanges and required traders to comply with "best execution" i.e. making sure clients get the best price, the fastest transaction time and the most efficient means of conducting their trades.
- MiFID required investment firms to be authorized and to comply with various regulatory requirements, including those concerning how business is conducted.
- MiFID recognizes that investors have different levels of knowledge, skill and expertise and therefore the regulatory requirements should reflect this.
- MiFID does this through the use of **client categorisation**.
- MiFID hence requires that banks segregate institutional clients (eligible counterparties and professional clients) and retail clients into separate categories according to their risk appetite. This has to be recorded.

2014 - The new MiFID world

Market Structure	Scope	Transparency	Investor Protection	Organisational Requirements
Automated trading and related issues Multilateral Trading Facilities ("MTFs") Organised Trading Facilities ("OTFs") Systematic internalisers SME markets	OTC Derivatives Commodities 'On market trading' of OTC derivatives	Pre-trade transparency Trade reporting Transaction reporting Data consolidation	MiFID activities, services and exemptions Appropriateness, Best execution, Best interests of clients Client agreements, Client assets, Client classification, Client money ECP and PC exemptions Inducements Liability Order handling Reporting to clients Research and Marketing Risk disclosure Suitability	Compliance, risk management and internal audit functions Conflicts of interest Employees Organisational obligations Telephone/electronic records Senior management

MiFID II – what changes for third countries?

- Before MiFID II, access by non-EU firms providing investment services or performing investment activities to the EU market was not harmonized. Access was governed by Member States' national third country firm regimes. There was no EU passport available for a Third Country Firm that establishes a branch in a Member State.
- During the legislative process, third country firms' access to the EU market was controversially discussed.
- After, the adoption of MiFID II, the situation became more complex: there is now a harmonized regime for professional clients whereas there is <u>no</u> harmonized regime for retail clients.

MiFID II - Eligible counterparties & professional clients

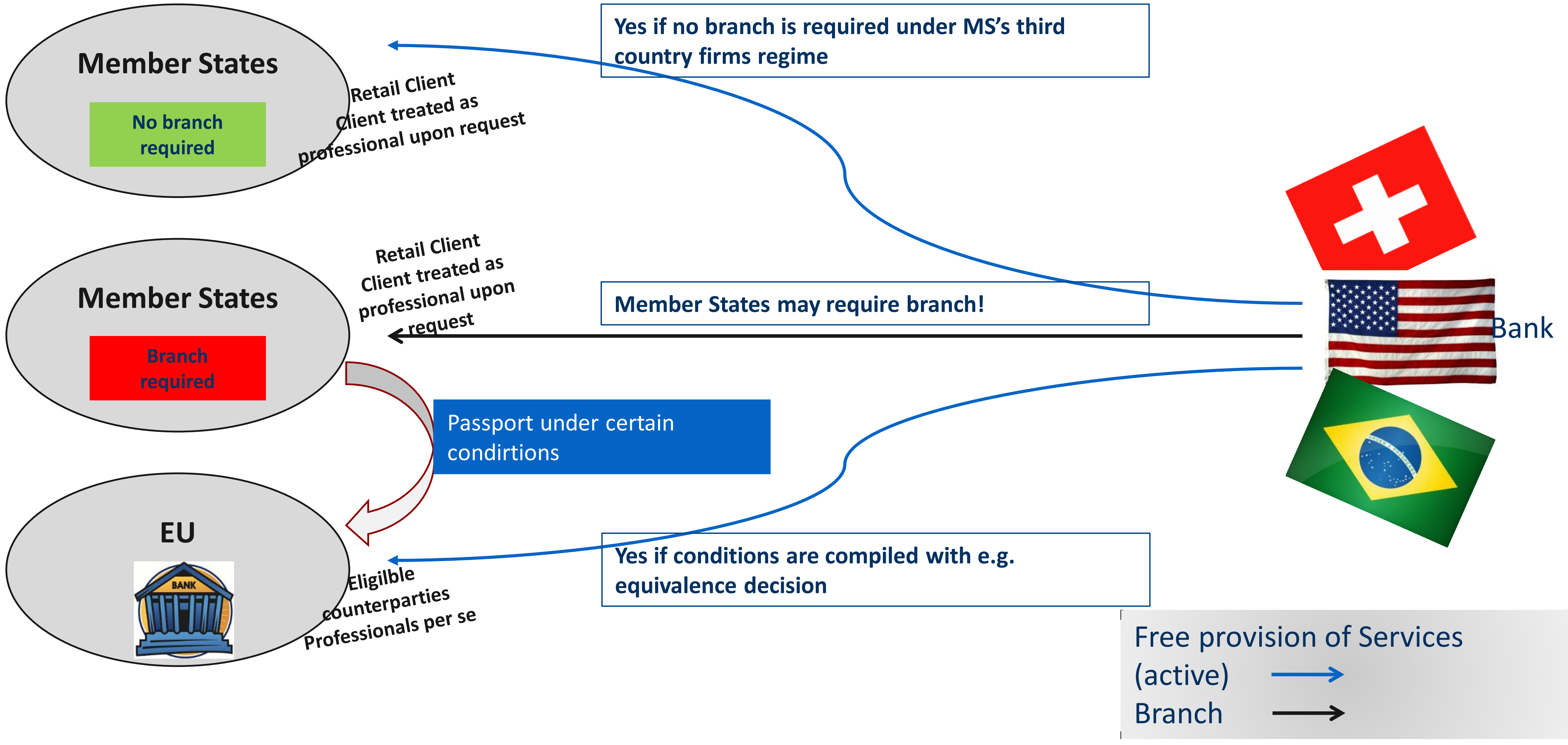
- **MiFID II proposes a harmonized system regarding the cross-border provision of services by Third Country Firms**: third country firm can provide services throughout the EU if:
    1. the European Commission has adopted an equivalence decision in relation to (let's say) Switzerland;
    2. the third county firm is authorized to provide the investment service in CH and
    3. there is a cooperation agreement between ESMA and (in this case) FINMA,

- **Regarding the establishment of a branch:** a firm which has an authorized branch in a Member State may provide services throughout the EU to eligible counterparties and professionals without establishing further branches.

MiFID II - Retail clients

- As regards retail clients, Member States may require that firms from a 3rd country wishing to provide investment services to clients on its territory establishes a branch in that Member State.
- Retail clients is a ‘rest category’ i.e. clients that are neither Eligible counterparties nor Professional clients.
- If a Member State requires the establishment of a branch in its territory to service those clients, harmonized MiFID II authorization rules will have to be complied with.
- As each Member State may require the establishment of a branch on its territory to service those clients, there is no “EU passport” for Third Country Firms available in this respect.

Third country firms – this is what it looks like…



Does it matter?

For Switzerland:

- Legal uncertainties have economic consequences.
- Access to the EU internal market is a major factor for the banks' growth strategy.
- Cross-border wealth management is an important activity for Swiss banks.
- It accounts for around 30 % of revenues and close to 7,000 jobs (source: SBA).
- Because of the lack of legal certainty Swiss banks they decide not to serve their EU clients from Switzerland.
- This could trigger an outflow of assets under management and a major shift of jobs from Switzerland to the EU

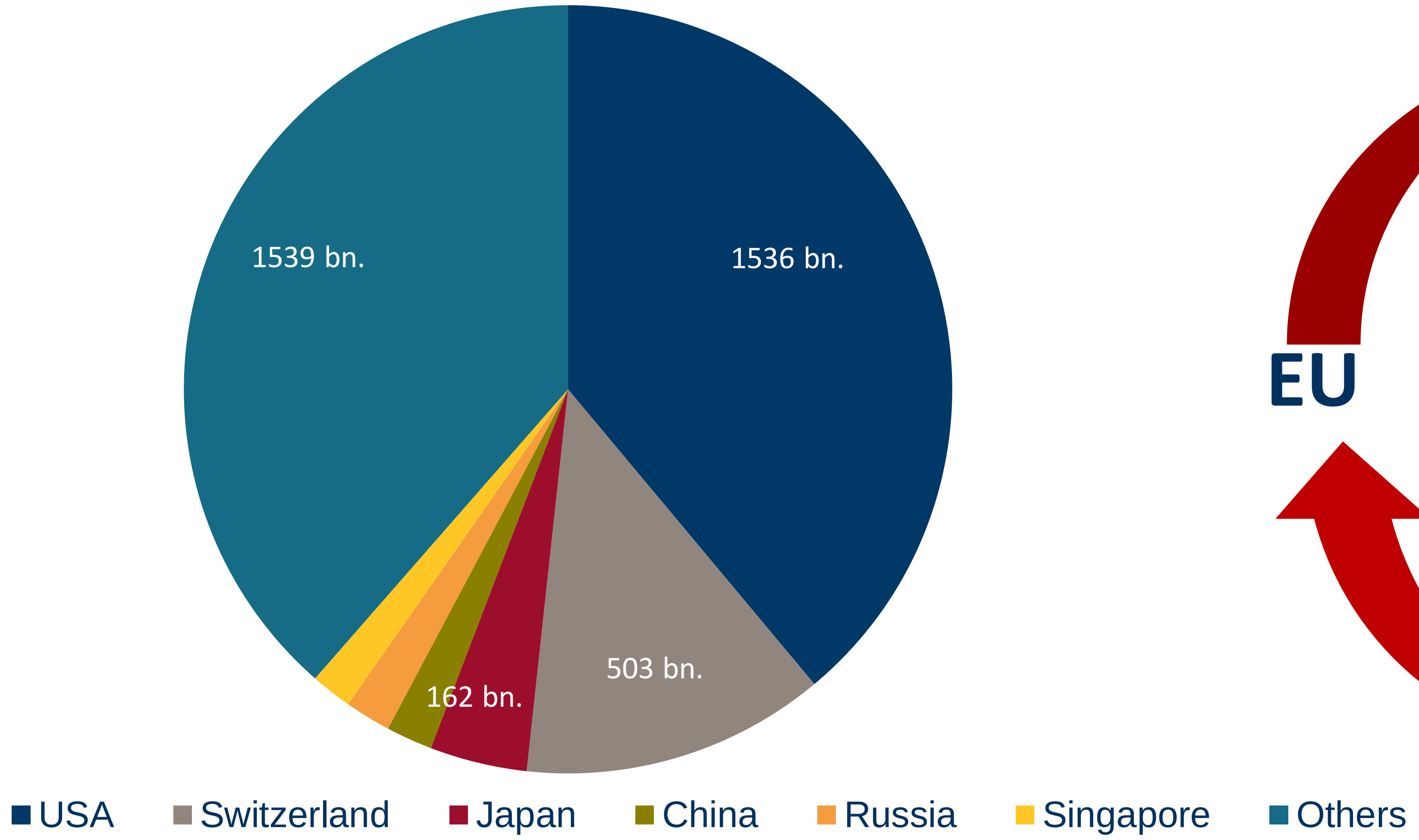
Does it matter?

For the European Union:

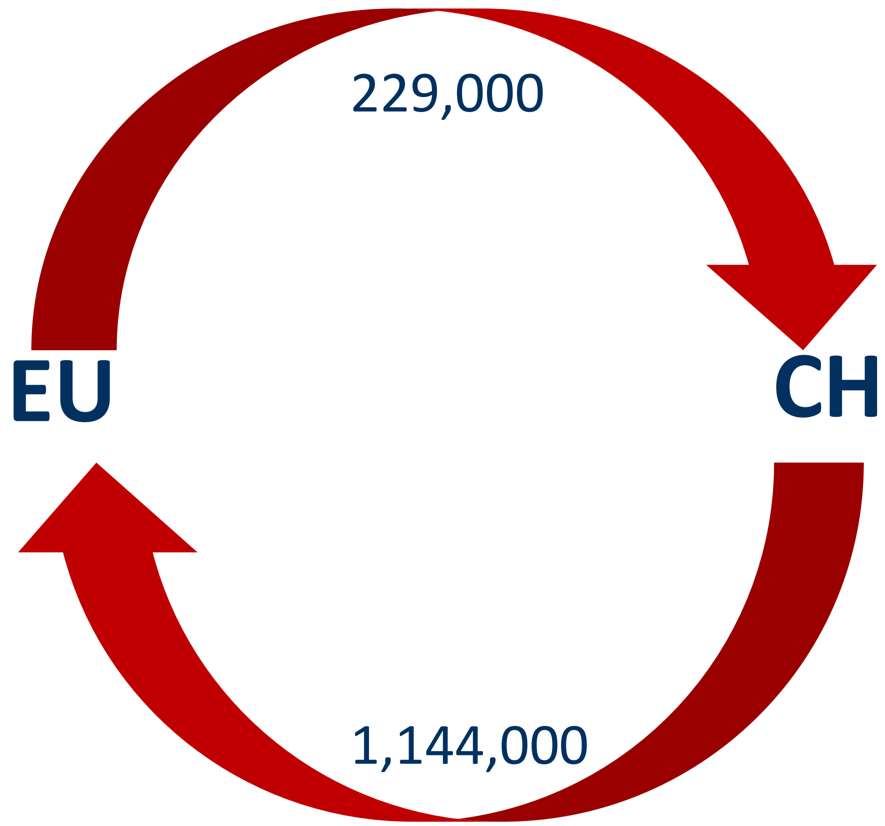
- Following the crisis, the EU has declined the most in terms of gross capital inflows and outflows as a percentage of GDP. They are lower in 2013 than in 2007.
- Europe has weak GDP growth, large divergences within the EU/Eurozone, subdued inflation, excessive public and private sector debt, slow deleveraging and structurally high unemployment…
- The EU wants to attract investors from outside the EU. For this reason, the green paper on the CMU also focuses on attracting international investments.

Capital and labour links

Stock of foreign direct investment in EU27, end-2012 in EUR bn



Workers employed in foreign-owned companies



Source: Eurostat (2012)

Does it matter?

- 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

Capital Market Union should promote open borders beyond the EU internal market borders

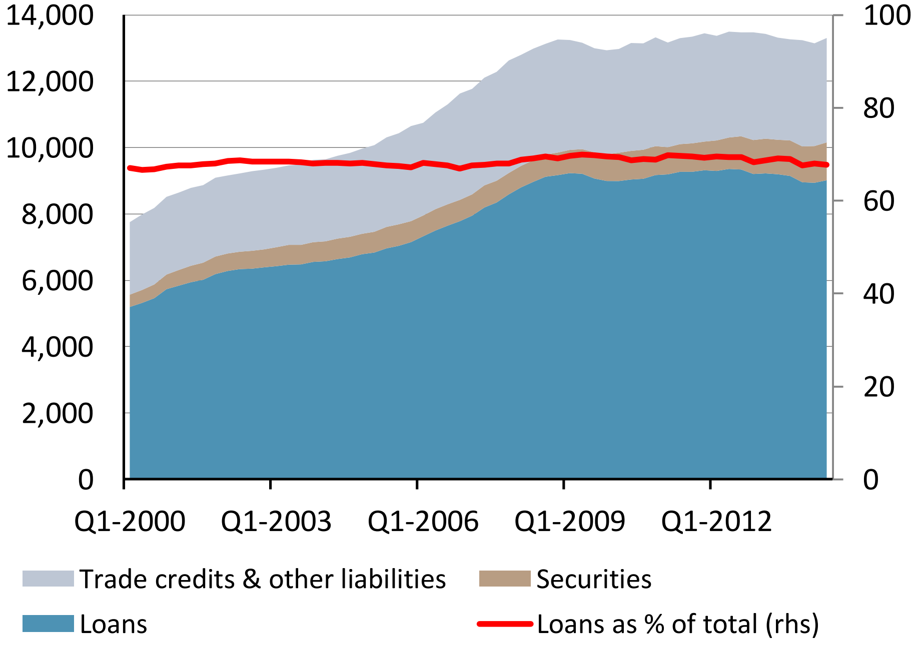
- Our members - Credit Suisse and UBS – have decided to launch a dialogue with EU stakeholders and to show the positive impact that cross-border provision of financial services and capital flows between the EU and its partner countries have on growth and jobs.
- The Capital Market Union (CMU) could help overcome existing barriers to the capital markets inside the EU.
- The Capital Market Union (CMU) could also help overcome existing barriers to access to the EU capital market.
- Our study also demonstrates the unused potential of European capital markets – EU plus Switzerland and Norway – is substantial.

The unused potential of European capital markets is substantial.

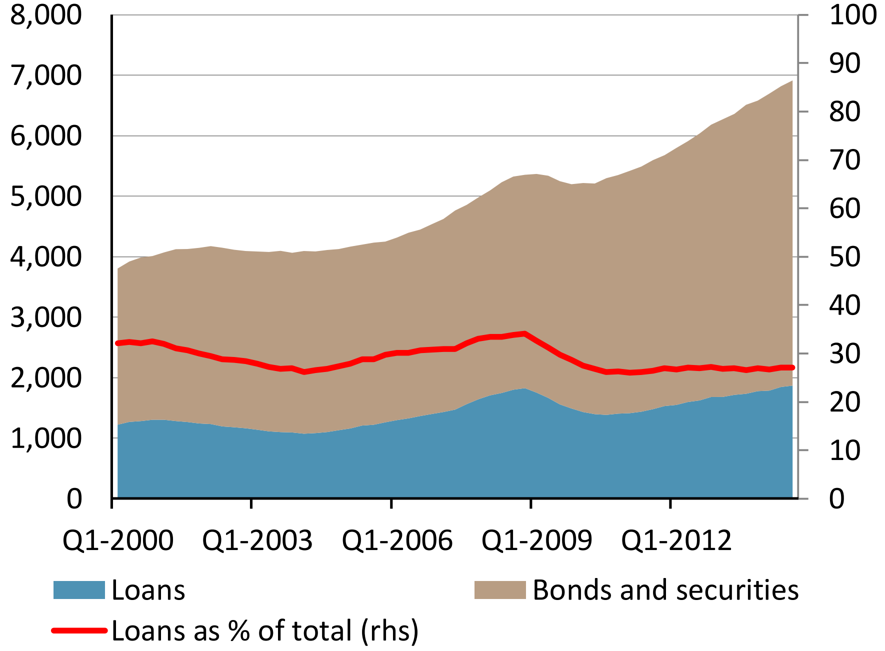
The aim of the Capital Markets Union (CMU)

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



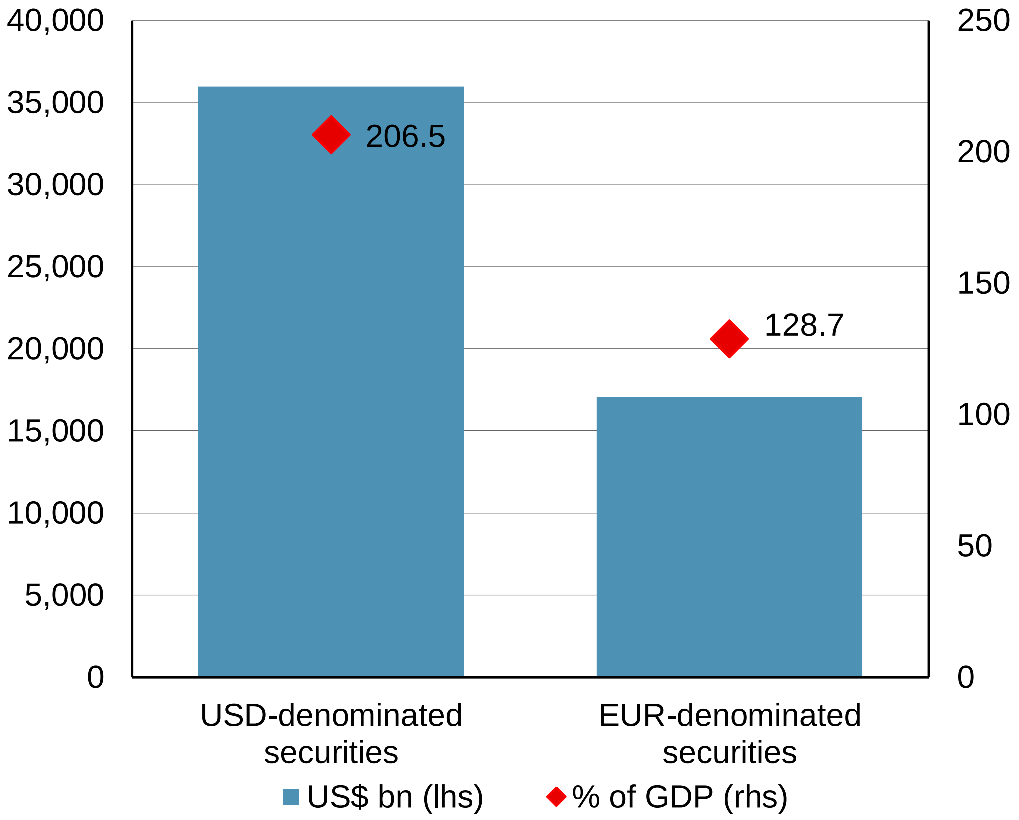
Corporate borrowing in the US, $bn



Source: Haver

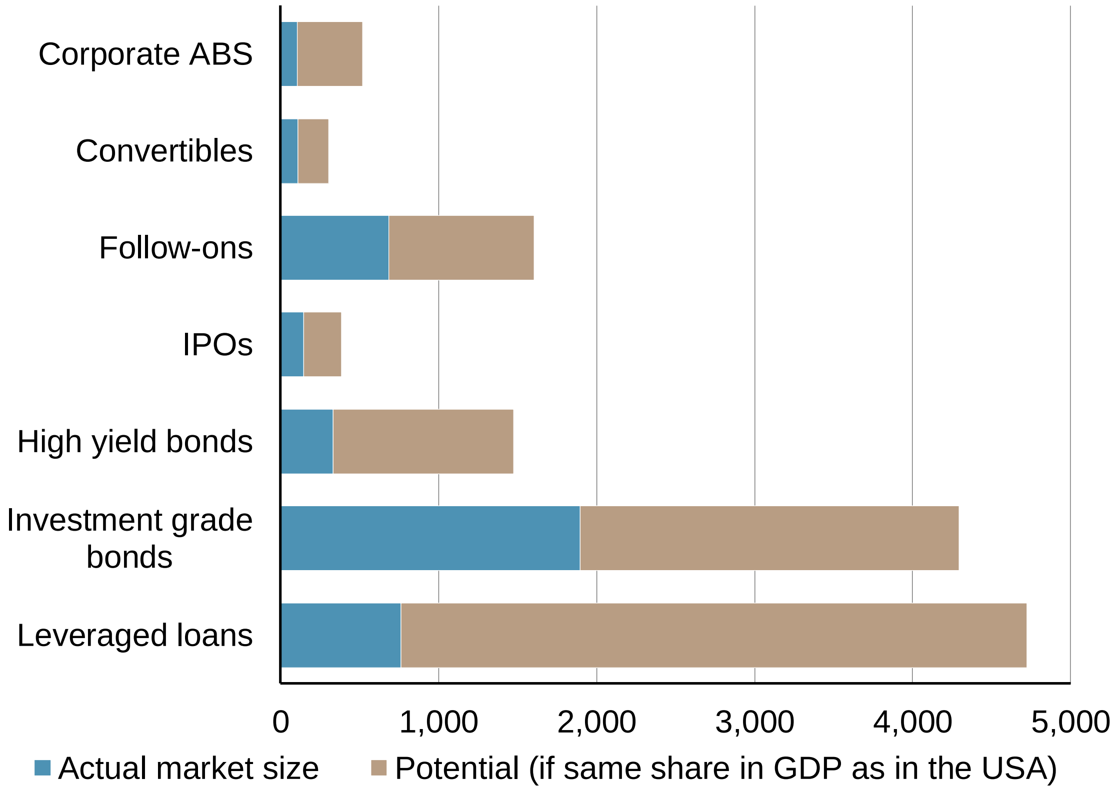
The upside of truly integrated capital markets

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

1st Recommendation: 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

2nd Recommendation:
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

3rd Recommendation:
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

4th Recommendation: Encourage greater cooperation between the EU and its main partner countries

At EU level

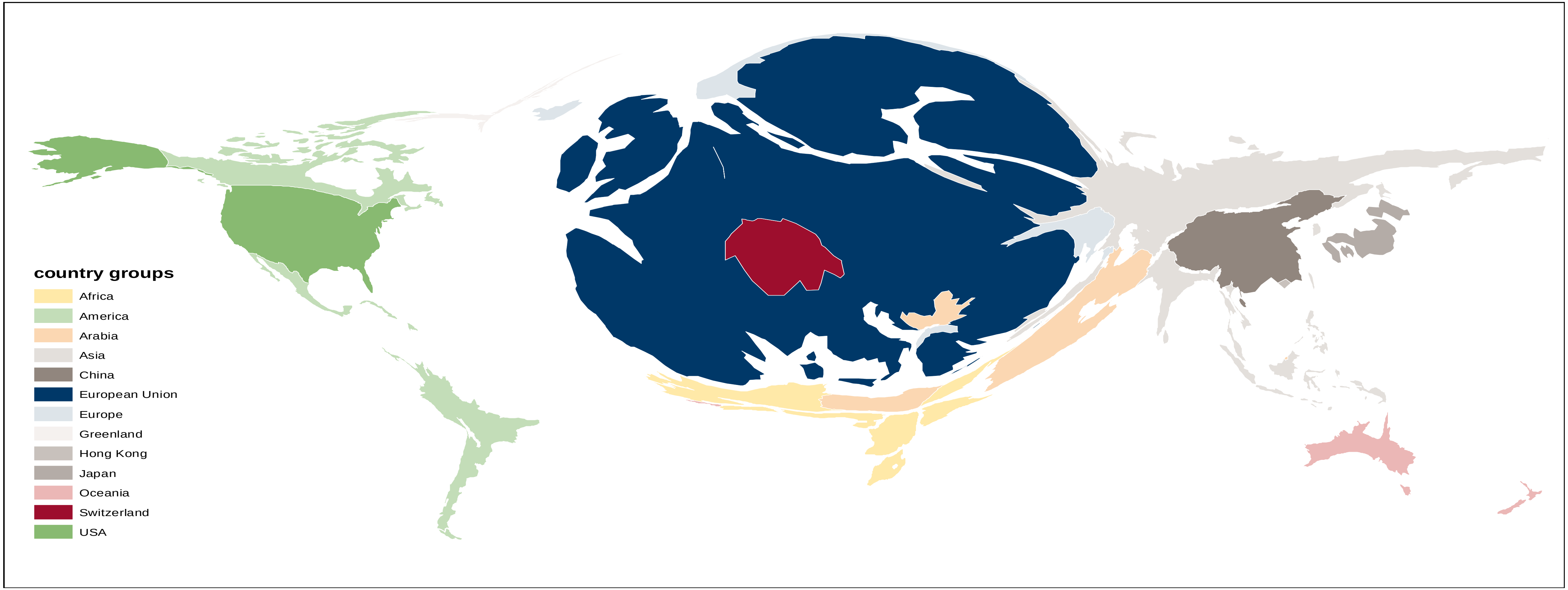
- Promote dialogue bilateral and multilateral dialogue with non EU policy-makers and regulators to assess the impact of proposed EU legislation on cross-border capital and investment flows
- Complete outstanding equivalence assessments and, if necessary, boost resources
- Develop a flexible and predictable principles-based regime for assessing equivalence with partner countries

At international level

- Involve 3r countries' authorities in the discussion about CMU to help ensure regulatory coherence
- Assess the impact of new laws on the ability of EU firms to access foreign markets and of foreign firms to access the Internal Market
- Avoid the creation of additional cross-border obstacles for investors and financial services
- Encourage cooperation between ESAs and international supervisors based on MOUs and regular dialogue
- Explore opportunities to conclude financial services agreements with key partners

An EU trade-adjusted world map

Areas sized by EU exports to countries/regions



Source: Federal Customs Administration (2013), Credit Suisse