SwissFinanceCouncil
Fostering International Dialogue

Enhancing the Capital Markets Union
SFC recommendations for next EU legislative cycle

Swiss Finance Council members include some of the largest global asset and wealth management firms, many of which have substantial activities and make substantial investments in the EU. Our members operate as investment product manufacturers, distributors, and advisors, serving EU clients from both within the EU and on a cross-border basis, and non-EU clients investing in the EU.

Given that the EU and Swiss economies are closely interconnected, we have a shared interest in ensuring the international competitiveness of the European economy. Our members are therefore deeply committed to the EU's goal of building an effective and open Capital Markets Union (CMU) that helps capital flow to EU projects and business that are key for the transition towards a more sustainable and digital economy.

Increasing the scale of the CMU also requires attracting external capital into the EU. The stock of Swiss Foreign Direct Investment (FDI) in the EU is around EUR 540 bn (2022), representing 41% of all FDI originating from Switzerland. The EU and Switzerland should look to strengthen their relationship, including through the consideration of measures that would promote provision of cross-border financial services and products, and cross border investment, to the benefit of businesses and investors across Europe.

We set out below a set of recommendations for the next legislative cycle that would allow Swiss firms to channel capital and expertise towards EU policy objectives.

SFC recommendations at glance

- **Grow the investor base for EU capital market products** by allowing sophisticated investors, including entrepreneurs and high-net-worth individuals, to invest more easily in EU funds and projects. Unlocking this investment power requires a change to the client categorisation framework under MiFID as discussed under the EU Retail Investment Strategy.
- **Allow third country jurisdictions and firms to contribute directly to the CMU.** Develop an institution-based approach that could offer a single point of entry for third country firms to provide cross-border financial services to the benefit of EU capital markets, in particular for closely connected markets such as Switzerland with high regulatory and supervisory standards.
- **Revitalise the EU securitisation market**, allowing banks to transfer some risk to investors, release capital, reduce dependence on deposit-funding and unlock additional lending. The prudential requirements for banks and insurers should reflect the high quality of issuances under the EU STS framework and improvements in the regulation of securitisation implemented in the EU since the Global Financial Crisis.
- **Improving the existing sustainability framework by focusing sustainability reporting on clearly valuable information**, through reconsidering the Green Asset Ratio (GAR) reporting obligation and limiting any additional reporting requirements in the forthcoming sectoral European Sustainability Reporting Standards (ESRS) to essential disclosures.
- **Unlocking climate transition finance opportunities via a pragmatic, investor oriented framework that optimises the design of existing tools**, including via clear transition pathways, interoperable transition plan requirements that allow firms to set transition plans at group level, and by using the forthcoming revision of the Sustainable Finance Disclosure Regulation (SFDR) to support the efficient allocation of capital to transition assets, via establishment of a clear product category for 'improvers/transition finance'.

Promote open, deep and efficient capital markets

Europe's capital market remains fragmented. More than ever, deep pools of long-term capital are needed to finance the twin green and digital transition and address the growing challenges of an ageing population.

An open CMU is key to attract external investment into the EU and connect EU investors to global investment opportunities. A particular focus should be on measures that can bring more size into the EU capital market in the medium term.

Revitalising the EU securitisation market

A genuine CMU would mean building a sufficiently large securitisation market, allowing banks to transfer some risk to investors, release capital, reduce dependence on deposit funding, and unlock additional lending. However, in the 15 years since the 2007-2008 financial crisis, securitisation in Europe has barely grown at all. EU issuance was equal to 0.3% of EU GDP (EUR 53 bn) in 2022 compared to US issuance (EUR 2 tn) at 1.4% of GDP. Restoring the securitisation market could be even more powerful in the EU's predominantly bank-based financial system.

The financial crisis highlighted the need for simpler, more transparent, and better supervised securitised products with less embedded leverage. The EU simple, transparent and standardised (STS) framework for securitisation promotes high quality securitisations (overall 96.5% of EU securitisations are of investment grade, compared to 66% in the US), with eligibility criteria that exclude the riskier types of securitisations that were the source of most of the losses during the financial crisis. 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.

It is vital to recalibrate the prudential framework applicable to insurers to restore the investor base for EU STS products as part of a broader move to introduce greater proportionality and simplification into the framework. Other aspects of the framework would also benefit from greater proportionality and simplification, thereby facilitating the issuance and acquisition of STS products. This would include a review of the highly complex criteria to qualify as STS, the significant risk transfer process, disclosure and due diligence requirements.

Broadening the investor base for capital market products

There are many sophisticated and high net worth retail investors in the EU who have the means to make an immediate and substantial contribution to EU capital markets. However, they are currently unable to do so because they are not considered as “professional investors” who are able to invest in certain Alternative Investment Funds - such as private equity and ESG funds - that can directly support European SMEs, unlisted businesses, or the EU's climate transition.

This can be addressed by establishing a more appropriate categorisation of clients in the review of MiFID 2 within the Retail Investment Strategy. The rules for ‘opting up’ from retail to professional investor status contain important protections to ensure that only those with sufficient sophistication and capacity can be treated as ‘elective professional’ clients. However, under the current proposal, once an individual has met the tests to opt up, they are only considered as professional for an individual asset class. This severely limits their potential to support the EU economy because wealth managers classify clients at a portfolio rather than asset class level. Becoming a professional investor in a single asset class would have little practical effect if their wealth manager continued to class them as a retail client. To address this, we recommend that a positive assessment applies to all of an individual's activities, rather than a single asset class. Similarly, the opt-up conditions are significantly geared toward natural persons and operating companies, at the risk of leaving aside other categories of legal entities such as family offices despite their level of sophistication.

Allowing third-country jurisdictions and firms to opt-in to 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.

The existing EU framework contains a complex array of market access provisions, which vary across the type of institutions, type of services and client categories. Therefore, the EU may want to consider a single point of entry for third country firms as an alternative to equivalence-based market access regimes.

Institution-specific approach to providing cross-border services

An institution-based approach for the provision of cross-border financial services would offer a harmonised framework at EU level for third country financial institutions to contribute to EU capital markets on the basis of an EU license.

By adhering to the same rules as EU financial institutions, it would furthermore guarantee a level playing field and fair competition, while offering high-quality services and a wide range of products for clients domiciled in the EU.

The participating third-country financial institutions could be subject to integrated supervision at EU level where appropriate, which would create a single point of entry into the EU market for these firms providing cross-border services into the EU. The approach would constitute an ideal platform for the EU to experience a controlled market opening to a closely connected third country, such as Switzerland, with high regulatory and supervisory standards.

Increase sustainable finance opportunities

Our members have significant expertise in sustainable finance, and in particular ESG funds. Increasing access to sustainable finance activities will be essential to meet the objectives of the EU Green Deal. It is also imperative for EU sustainable finance rules and standards to be globally coordinated, coherent and interoperable, so that internationally active banks and asset managers can support global decarbonisation efforts and to allow markets to efficiently price climate-related risks and opportunities.

As a global leader in sustainable finance, the next phase of policy development in the EU should ensure enhanced capital flows into sustainable investments to enable the transition to a low-carbon economy. We would note in this respect that practical experience of the established reliance of the EU Sustainable Finance framework on the EU Taxonomy has revealed some important limitations of this approach due to the complexity and binary nature of the EU Taxonomy. While, as we understand, efforts will be deployed to improve the usability of the EU Taxonomy, appropriate consideration should also be given to the fact that the taxonomy is a tool providing information on the end green destination and that the real economy has rather recently embarked on its transition journey which requires other tools to be appropriately guided as per our recommendations below.

To enhance the efficiency of the EU Sustainable Finance regulatory framework and accelerate transition finance for net zero, we recommend:

Unlocking climate transition finance opportunities through a pragmatic, investor-oriented framework that optimises the design and use of existing tools

We believe that such operative framework requires:

- **Transition pathways for all economic sectors:** At a time where the economic transformation to Net Zero is still at an early stage and where the majority of the funding must accordingly go to industries that need to make the transition rather than to established ESG leaders, a critical step in unlocking finance for the transition is understanding the pathways and milestones that each sector of the economy needs to take to be consistent with the goals of the Paris Agreement. To have clear transition pathways is very important to help firms develop credible climate transition plans as well as to enable investors to assess' firms journey towards green.
- **Clear, interoperable transition plan requirements for financial institutions:** Coherent interplay of transition planning requirements in the EU (under CSRD, CSDDD and CRD6) as well as a recognition that climate transition plans are set at an individual bank's group level and reflect the different decarbonisation pathways of jurisdictions is needed. EU legal entities of global financial institutions should be able to leverage their group-level transition plan, if available, in satisfying their EU entity-level transition plan obligations under CRD6 and forthcoming EBA guidelines on management of ESG risks.
- **A clear product category for 'improvers/transition' finance:** The forthcoming revision of the Sustainable Finance Disclosure Regulation (SFDR) should ensure that the concept of transition finance is appropriately recognised and incorporated by this framework with a view to support the efficient allocation of capital to transition assets, which are key for a rapid shift of the real economy to sustainable practices and initiatives. This sustainable product category should cover products seeking improvements across any environmental, social or governance metrics and should not be limited to climate transition investments. The establishment of a sustainable product category for investments in transition assets would allow to more effectively channel transition finance by giving them enhanced visibility and providing investors clarity on the nature of their investment. This would dispel the current uncertainty regarding the classification of financial products supporting climate transition as sustainable investment (Article 9) or products promoting environmental and social characteristics (Article 8).

Improving the existing sustainability framework by focusing sustainability reporting on clearly valuable information

- **Reconsider the Green Asset Ratio (GAR) reporting obligation:** The forthcoming GAR review should ensure that thorough consideration is being given to the usefulness and usability of the information delivered by the GAR reporting, especially in view of the extensive resources mobilised by banks to run this complex reporting exercise. The GAR does not capture transition finance since the EU Taxonomy adopts a binary green/non-green classification system, nor accounts for the challenges faced by banks in collecting EU Taxonomy data from their clients/investees. In this respect, the review should take into consideration whether the GAR can provide a meaningful metric allowing stakeholders to understand banks' contribution to EU's climate and environmental objectives as well as to assess banks' efforts to finance the green transition and their progress on meeting their sustainability commitments.
- **Value creation focused sectoral European Sustainability Reporting Standards (ESRS) for financial institutions:** The forthcoming financial sector-specific ESRS should limit any additional reporting requirements to disclosures deemed essential to understand the material sustainability impacts, risks and opportunities (IROs) of financial institutions. The focus should not be on any incremental obligations under sector specific standards for the financial industry, but on explaining how the sector-agnostic standards can be applied in a proportionate way, given that applying them to thousands of investments is a very different exercise to applying them to an individual operating company.

Swiss asset managers commitment to sustainable investments

Switzerland is a leading location for sustainable finance, in particular ESG funds. Beyond compliance with sustainable finance regulation, the Swiss Asset Management Association (AMAS) developed a stewardship code that sets out best practices for Swiss asset managers to proactively engage with the companies they invest in and to hold them to account on their ESG commitments. Integrating stewardship in the investment process helps drive long-term sustainable development as well as returns for investors.

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The Swiss Finance Council (SFC) engages in dialogue around policy developments in finance at a European and international level. It represents the interests of internationally active Swiss financial institutions and provides a platform to share their experience, expertise and knowledge through a permanent representative office in Brussels.