bankenverband

Comments

of the Association of German Banks on the capital markets union 2022

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Introduction

To ensure its global competitiveness, financial stability and not least its economic sovereignty, the European Union urgently needs a deep and less fragmented capital market. This is becoming increasingly clear with each political crisis and challenge, which is usually also accompanied by a growing need for capital – be it Brexit, climate change, the pandemic, war or energy policy. Because one thing is clear: investments in the transformation of the economy cannot be financed by bank loans and the public purse alone; enormous sums of money need to be mobilised at the same time on the capital market. The prerequisites for achieving this are an efficient EU capital market and harmonised framework conditions – in other words, European capital markets union. To accomplish this, the EU must succeed in making a significant leap forward in terms of integration. And if not now, then when?

The private banks point to the **urgency** of pressing ahead with capital markets union as a matter of the highest priority and call on policymakers to launch key **measures** based on sound **guiding principles** in the coming months.

1. Urgency

- The need for capital markets union has never been more urgent. The events of recent years point to a global **dynamic** that the EU will only be able to master with a strong banking market and an equally strong capital market operating in tandem.
- It is true that financing, both through bank loans and through capital markets, works satisfactorily across the EU on the whole and even, in countries such as Germany, very well. Nevertheless, the existing **potential** of both capital providers and capital users is not being exploited to the full. Yet this is essential if the challenges of today and tomorrow are to be financed while enabling citizens to participate in growth.
- The **transformation** of the economy requires huge investment. This particularly concerns innovation in the areas of sustainability and digitalisation. In addition, a new global political situation demands adjustment and companies need to make business models more resilient through greater diversification of their supply chains (especially for energy and raw materials) and sales markets.
- When diversifying, as well as when modernising technology and business models, the EU has to **compete** with other parts of the world and cannot afford delay. With over than 90 per cent of global economic growth now being generated outside the EU (and in the US growth is also stronger than in the EU) and attracting investors accordingly, the competitiveness of our economy – and our financial markets – must take top priority.
- The special financing challenges of transformation are well known: change and innovation sometimes involve longer loan terms, possibly accompanied by later returns, higher risks, different collateralisation and large volumes overall. Without tapping private capital both from European and global investors as well as from retail investors in the EU, it will not be possible to finance the investments required over the next ten years. A **triad** is needed of bank loans, public funds – and the capital market.

2. Guiding principles

- Cross-border integration is an absolute prerequisite for capital markets union. But legal regimes that have evolved nationally continue to stand in the way of rapid and complete harmonisation. With **targeted harmonisation** of important aspects in certain areas (such as tax, insolvency or supervisory law), the EU could make a decisive contribution to overcoming fragmentation.
- Legal requirements must strike a balance between the interests of **issuers** on the one hand and **investors** on the other. This is the only way to ensure the stability and efficiency of capital markets.
- Investors must have the information they need to make responsible and free decisions. At the same time, all issuers must be subject to comparable regulation to ensure the **integrity** of the capital market.
- With effective **legal foundations** that are dependable throughout Europe, market participants will be able to develop solutions and products that are competitive and meet the needs of the economy.
- Investors and issuers are usually **bank** customers. Banks are efficient in bringing together capital-seeking issuers and capital-providing investors; they are intermediaries and major service providers in the capital market.
- Capital markets union therefore needs **strong issuers, strong investors and strong banks**.

3. Key measures

- **Progress** will only be possible with the support of member states and a corresponding demand from issuers and investors. In this context, it remains the task policymakers to provide important impetus and move key measures forward.
- The private banks believe the following projects need to be pursued with ambition **in the next few months**.

3.1. Securitisation

- Securitisations are the central instrument for building a bridge between loan-driven financing, especially of small and medium-sized businesses, and the capital market. To enable the European securitisation market to regain momentum, the **securitisation framework needs to be revised** without delay.
  - Overly conservative risk weights and floors should be recalibrated, especially for low-risk senior tranches.
  - The process for the recognition by supervisors of significant risk transfer, which is an absolute prerequisite for a securitisation, should be speeded up and simplified.
  - Certain securitisations should be classified as high-quality liquid assets (HQLA) for the purposes of the liquidity coverage ratio.
  - Reporting requirements should be streamlined so there is no need to prepare superfluous reports.
- In addition, it is vital to avoid further disadvantaging European securitisations as an asset class despite their good performance both during and after the financial crisis. There is a huge danger of this as a result of the output floor envisaged in the 2021 Banking Package, which would further disproportionately increase the risk weights of certain low-risk securitisations. The so-called “p” factor needs to be halved. The p factor leads to a blanket risk premium for securitisations and was originally intended to cover risks that have since been reduced by measures introduced in the last securitisation review (such as risk retention). The factor was not adjusted, however. Halving the p-factor would be a good way of mitigating the effect of the output floor on securitisations – an effect which, in our view, has not been well thought through.

3.2. CCP clearing

- The private banks support the European Commission’s objective of strengthening the **EU clearing market** and thus reducing its dependence on UK CCPs, among others.

- It is nevertheless crucial not to do so by forcing CCPs to relocate to the EU with measures such as increased capital requirements or quotas. Such measures will only damage institutions in the EU and cut off their access to international markets.
- The EU market – capital markets union – continues to depend on **access to international markets**, including international clearing markets. Measures therefore need to strengthen the long-term competitiveness of the EU clearing market and – in doing so – increase its attractiveness to international market participants. We need to press ahead with making clearing more efficient and standardising the legal and regulatory framework for EU clearing.
- Many of the measures currently under investigation by the Commission still go in the wrong direction (especially the EMIR clearing obligation, increased capital requirements for systemically important third-country CCPs and targets for reducing positions). Some of the measures under consideration make good sense, by contrast, and will help to strengthen the EU market (broadening the scope of clearing participants to include pension funds, public authorities and businesses; stronger role for ESMA in supervising CCPs; possibly also the maintenance of "active accounts" provided that damaging mandatory measures can be avoided).

3.3. Modernising the regulation of EU capital markets (MiFIR, CSDR)

- Capital markets union faces global competition. The EU capital market needs to be attractive to non-European investors while the access of EU players to global markets – including the UK – must remain competitive.
- The **competitiveness** of EU markets is dependent on the regulatory framework – and on how it compares to those governing international markets. Regulation must set the necessary parameters but should not hamper business with unnecessary bureaucracy. Existing regulations must be simplified and geared towards market needs. A lot of rules and reporting requirements are currently too complex and often redundant, which tends to dry up the markets or encourage **business to relocate** outside the EU or migrate to unregulated areas of the financial markets and new market participants.
- The EU must **not close off** its capital market. It should therefore also take account of capital market regulation in third countries, such as the UK, and the equivalence system. The objective should be to achieve the greatest possible compatibility with other global regimes.
- **MiFIR and the CSDR** should therefore be **revised** with the following points in mind.
  - When amending the rules on post-trade transparency in bilateral bond trading, EU lawmakers must ensure that **liquidity in the secondary market** is preserved – and not damaged by the drastic tightening of the deferral regime now proposed. We therefore strongly recommend implementation of ICMA's "Proposal for a new post-trade transparency regime for the EU corporate bond market" since it considers the needs of both sides – buyers and sellers – and is practicable. It would also allow the planned consolidated tape to be fed with meaningful data. Otherwise we fear adverse effects not only on the secondary

market but also on the primary market and the relocation of business to markets outside the EU.

- To protect retail investors/consumers, banks in the EU are, quite rightly, required to execute client orders in the best possible way (best execution). When revising **best execution reporting obligations**, the European Commission should rigorously delete requirements which are onerous yet deliver no added value – especially for small investors.
- The EU Central Securities Depositories Regulation (CSDR) regulates the settlement of trades by CSDs. The aim is, among other things, to ensure that securities transactions are settled promptly and efficiently. The **mandatory buy-in** was introduced as a measure to promote settlement discipline. Since buy-ins are an instrument designed to protect the buyer and thus belong on trading level, the measure, if made compulsory during settlement, will cause a whole host of problems. On top of that, the practice is not common outside the EU. Forcing all buyers of securities to make use of a right to obtain the securities elsewhere is neither proportionate nor does it take adequate account of the interests of the aggrieved buyer. Enshrining the arrangement at settlement level in a way alien to the system would, in addition, have a negative impact on market activities and market liquidity. The private banks therefore recommend dispensing with mandatory buy-ins when exploring how to improve settlement efficiency.

3.4. Insolvency law

- Complete harmonisation of corporate insolvency regimes in the European Union would be an extremely complex and time-consuming project: existing national insolvency law and its institutions such as insolvency courts, insolvency administrators, etc. differ substantially from one member state to another. This also applies to adjacent areas of law, especially company, labour and tax law.
- It would make more sense and take less time to develop **targeted harmonisation** measures for certain aspects of EU capital market regulation, particularly the insolvency treatment of intermediaries. This should be applied in a harmonised manner; netting should also be recognised throughout Europe.
- If further EU harmonisation of corporate insolvency law is sought, it will be important to respect **key principles of sound corporate insolvency law**. This is because poorly harmonised insolvency law could do far more harm than good, including to European capital markets union. A good insolvency regime will take adequate account of the following elements, in particular: the function of insolvency proceedings, cause of insolvency, obligation to file for insolvency, monitoring of insolvency proceedings by the court and insolvency administrator, avoiding a lack of assets in the insolvency estate, preserving the ranking of creditors/special position of secured creditors, the right of creditors to have a say, the continuation of business after insolvency, the close connection of insolvency law with adjacent areas of law and, finally, the treatment of insolvency issues affecting the market, meaning clear rules should be enshrined in the insolvency regime to protect netting agreements and derivative contracts.

3.5. EU green bonds

- We support the European Commission’s aim of establishing the first legal framework for green bonds with its EU Green Bond Standard. The link with the EU taxonomy will set binding parameters for issuing green bonds, increase confidence in green bonds and reduce search costs for investors.
- It is crucial, however, that the EU Green Bond Standard is a voluntary standard alongside other internationally recognised standards (such as ICMA’s GBP). Issuers will continue to need access to other recognised green bond standards to finance activities that do not qualify as green under the taxonomy’s current criteria or those under development, but which nevertheless support the transition and are considered sustainable by investors.
- Otherwise, European issuers will once again suffer considerable damage to their ability to compete and innovate.