# EUROPEAN FINANCIAL SERVICES SECTOR OUTLOOK FOR 2023

MARCH

## SERVING CUSTOMERS AND THE EUROPEAN ECONOMY

European Financial Services Round Table

*With economic activity in Europe not growing as fast as we had hoped and with a slow-down in the world economy and in international trade, it becomes more and more important that the competitive edge of industry in the Community should be sharpened. The only way that this can be done is if [the people of Europe] deploy the full resources and opportunities of an internal market [...] The political will is clearly there. The challenge lies in translating that political will into positive action.*

**Lord Arthur Cockfield, European Commissioner for internal market and services,** 1987.

*In the face of the new geopolitical reality, the European Union will act decisively to ensure its long-term competitiveness, prosperity and role on the global stage. The European Union will strengthen its strategic sovereignty and make its economic, industrial and technological base fit for the green and digital transitions. It will deepen the Single Market and ensure a level playing field both internally and globally.*

*It is essential for the European Union to enhance its long-term competitiveness and productivity. A comprehensive strategy should further harness the full potential of the Single Market, which has underpinned Europe's prosperity since its creation 30 years ago. Recalling its December 2022 conclusions, notably its invitation to the Commission to present a strategy at EU level to boost competitiveness and productivity, the European Council will revert to these matters at its upcoming meeting.*

**Conclusion of the Special meeting of the European Council,** 9 February 2023.

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# A. INTRODUCTION

The world economy has started 2023 with a large number of major and difficult challenges with geopolitical turmoil, energy crisis, inflation and macro-economic volatility having a big impact. All of this is also affecting the European economy.  In its World Economic Outlook (WEO) of October 2022, the International Monetary Fund (IMF) wrote that global economic activity is experiencing a broad-based and sharper-than-expected slowdown, with inflation higher than seen in several decades. While in October 2022, the IMF forecasted global growth to slow from 6.0 percent in 2021 to 3.2 percent in 2022 and 2.7 percent in 2023, the IMF updated this forecast the end of January 2023, predicting 0.2 percentage point higher than in the October 2022 WEO. According to the IMF the balance of risks remains tilted to the downside, but adverse risks have moderated. The January 2023 forecast is therefore that global growth is projected to fall from an estimated 3.4 percent in 2022 to 2.9 percent in 2023, then rise to 3.1 percent in 2024. At the World Economic Forum (WEF) in January 2023, IMF Deputy Managing Director Gita Gopinath had already announced an update of its forecasts for the global economy to reflect "improvement" in the second half of 2023 and into next year. However, Mrs. Gita Gopinath also warned that 2023 would nevertheless be a tough year, with inflation still too high, meaning that central banks should stay the course with interest rates rising until inflation falls in a sustainable way.

In its Annual Growth Survey 2023, which was published on 22 November 2022[1], the European Commission (EC) has set out guidance to help tackle the energy crisis and make Europe greener and more digital. On the one hand, they proposed coordinated action to secure adequate and affordable energy supply. At the same time, they stressed that rapid action is needed to boost potential growth and quality job creation and to deliver on the green and digital transitions, which are also already included in the EU Recovery Plan NextGenerationEU.

In that same report, the EC also rightly noted that a properly functioning single market, where fair and effective competition is ensured, is key to boosting productivity and growth. Since the start of the single market in 1993, a lot of measures have been taken and progress has been made in establishing the single market. Under the Czech EU Presidency, a Conference was organised in Prague on 8 December 2022 to kick off the celebrations of the 30th anniversary of the Single Market. On that occasion, Commissioner Breton described the progress that has been made on the single market and the tangible benefits it offers to European Citizens and businesses.

The EFR fully subscribes to the importance of a European single market since a fully integrated EU financial market, a single market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services and a competitive European financial services industry. This is conditional for realizing the Green Deal, making the digital transition, better offerings in both value and services for all European users and to ensure a safe and secure financial infrastructure across the Member States of the EU.

However, the single market for financial services has still not been completed. While important steps have been taken – most certainly also the last decade with the setting up of the Single Supervisory Mechanism and the European Supervisory Authorities, for instance - the reality is that financial institutions are still facing fragmentation with regard to regulation and supervisory approaches within the single market. Furthermore, the Capital Markets Union (CMU) and the Banking Union are still far from being established in full.

On the business side, five European business associations[2] issued a joint statement on 27 June 2022 with a call for fresh political engagement to renew economic integration in the single market, since they no longer experienced the Single Market as a true free trade area. In their recommendations they state that the

1 COM (2022) 780 final.

2 BusinessEurope, DIGITALEUROPE, ERT, Eurochambres and EuroCommerce.

European Commission, European Parliament and Member States' governments need to reinstate the idea of a Single Market as an economic union for free trade without internal obstacles and bring freedoms back to the top of the political priorities. Furthermore, they asked for the removal of all barriers to cross-border business operations and intra-EU investments, forming a fully-fledged Single Market for all economic activities. At the WEF meetings in Davos in January 2023, business leaders also raised concerns about the current atmosphere of deglobalisation and global fragmentation.

These concerns expressed by both the financial and the business sector regarding the single market should be addressed properly. Given the paramount importance of energy, sustainable and digital transitions and the envisaged role for the financial sector in financing the European economy, completion of the single market is a number one priority. Internal fragmentation should be eliminated to allow European firms to employ capital and liquidity more efficiently and fully shift their focus towards supporting growth. Furthermore, there should be a focus on unlocking growth opportunities through more efficient allocation of savings towards long-term investments. This is all the more important given policymakers' growing concern about safeguarding European economic competitiveness against a backdrop of deglobalization and regional economic protectionism.

For the European financial sector to play its role in the single market it is also vital that there are no unnecessary legal or regulatory restrictions. In the same way as it should be a requirement for every jurisdiction, a sound financial regulatory and supervisory framework is crucial for the proper functioning of the European financial sector. It is important that this framework is adequate and proportionate, while at the same time respecting the risk-based nature of the financial sector, whose role is to support business and the European economy as a whole. Regulation needs to concentrate on transparency and stability in financial markets, ensuring a European as well as a global level playing field and supporting the European financial industry as a central player in the European economy. Furthermore, regulation should not be continuously subject to change because such regulatory instability leads to very high costs that are ultimately passed on to customers.

In other words, European regulatory regimes must be and must remain fit for purpose to ensure that available banking capital, insurance investment and the competitiveness of the European financial sector support the sustainable growth of the real economy, the development of capital markets as well as the energy, sustainability and digital transitions.

By publishing this annual report, the EFR is contributing to the debate on key issues for the financial sector, offering specific recommendations to EU policy makers. In addition to a focus on meeting the huge financing needs of the European economy, a number of other challenges and new projects are also addressed. In order to contribute to the development of the CMU, the upcoming European Retail Investment Strategy should aim at increasing retail participation in capital markets by ensuring the availability of financial advice and access to diversified investment products, while preserving high standards of investor protection. Concerning Central Bank Digital Currencies, the discussion on the potential introduction of a Digital Euro will continue. It will be important to involve all stakeholders and the case should be made clearly that there will be added value to the European economy and consumers. In the European discussion on strategic autonomy, the topic of Digital Sovereignty should also be addressed. The lack of a unified interpretation at European level of what digital sovereignty is and how it can be achieved might end up creating fragmentation in the approach to increase digital sovereignty and the required implementation of legal and technical solutions.

The EFR Members reiterate their unwavering commitment to continue supporting their customers and the European economy. This report provides guidance on how the financial sector should be accommodated to play its envisaged role.

# B. SUMMARY OF MAIN ISSUES AND KEY RECOMMENDATIONS

In order to enable the European financial services sector to support the European economy, the European Financial Services Round Table gives the following key recommendations.
Full details are given in Section C of this report.

## GENERAL PRINCIPLES

Regulation should be aimed at transparency and stability in financial markets, that ensures a level playing field between market participants, fosters their competitiveness, and that is supportive of the European financial industry playing a central role in financing the European economy, for the benefit of all parts of society.

Cooperation and coordination at global level is vital for the EU. The EU should ensure that measures taken in the EU do not create global competitive disadvantages for the European financial sector. Furthermore, open EU borders should be ensured in order to keep the EU attractive for international (financial) institutions bringing knowledge, innovation, and investment.

## KEY RECOMMENDATIONS

### 1. Empowering retail investors to meet the European challenges of the twin digital and green transition

- EFR welcomes initiatives to empower retail investors to participate in and embrace the digital and sustainable transformation and calls upon policymakers to seize this critical opportunity to modernise regulation. As a first step, the digital transformation requires embracing a 'digital-by-default' approach, allowing for disclosure in a digital format, while catering for customers who still prefer paper. In addition, reforming the MiFID II opt-up criteria to allow sophisticated investors with strong capital markets expertise to access a wider range of investments such as private equity would increase funding opportunities for companies, including SMEs that want to grow.

- EFR is opposed to an EU-wide ban on the payment of inducements for the sale of retail investment products as this would create an advice gap and ultimately discourage EU retail investors from participating in capital markets. We recommend maintaining the current coexistence between fee and commission-based distribution models and striving for increased transparency.

### 2. Tackling the Huge Financing Needs for a European Economy fit for both transitions

- EU policymakers should deploy their resources to a small set of priority actions that will revive and generate new financing channels for the economy:
  - a true revival of securitisation;
  - initiatives that will foster long-term investment and help mobilising the large reserves of private savings / pensions to finance them;
  - designing a European framework to facilitate targeted long-term investment projects through public-private-partnerships.

- European policymakers need to ensure that all new rules work consistently and coherently to support the growth objective and the competitiveness of the European financial sector; for this to materialise policymakers need to:
  - evolve towards a smart regulation given the financial sector is on a significantly more secure footing following comprehensive post-crisis reforms, with banks and insurers proving resilient during the pandemic;
  - target further regulatory initiatives on specific objectives, proportionate to their aim and thoroughly impact assessed to ensure they do not adversely impact the supply of finance to the European economy;
  - introduce a systematic competitiveness check that reviews the capacity of the European financial sector to contribute to the growth of the European economy;
  - ensure there will be no new barriers on the financial market in Europe;
  - ensure a level playing field with other major jurisdictions, in particular when implementing international standards such as Basel III, or when reviewing the EU's insurance rulebook, Solvency II.

## 3. Meeting Digitalisation challenges

### Central Bank Digital Currencies

- CBDC will only be a success if all stakeholders are fully convinced of its usefulness and its characteristics make it an added value both for end users and the intermediaries that will distribute it.

- Banks should be actively involved in the discussions on the digital euro, both at the strategic and technical level, as pivotal players for its deployment. In particular the core design aspects that require special attention are: the allocation of duties between the ECB and the intermediaries, a robust business model based on fair compensation concerning costs, privacy and data issues, the preservation of financial stability, financing of the economy and a flourishing and diversified European payments eco-system, as well as the security features to prevent fraud.

### Digital Sovereignty

- EU and US public authorities should enhance cooperation in order to design consistent frameworks for the development and deployment of new technologies. In that regard, the discussions undertaken in the context of the Trade and Technology Council are a constructive step to drive digital transformation based on common values.

- Sovereignty and freedom of choice is enabled by competition and the market offer. Therefore, policy actions should promote an innovation-friendly regulatory framework in the EU that encourages investments in IT developments. It is necessary to increase the market offering rather than limiting access to technology based on the provider's location.

# C. MAIN ISSUES TO BE ADDRESSED SO THAT THE EUROPEAN FINANCIAL SERVICES SECTOR CAN PLAY ITS ROLE IN THE EUROPEAN RECOVERY

## 1. Empowering retail investors to meet the European challenges of the twin digital and green transition

### Introduction

The EFR welcomes the European Commission's ambition to unlock the potential of the Capital Markets Union for retail investors and work on a dedicated Retail Investment Strategy. To give retail investors more opportunities and confidence to invest for long-term investment to protect their savings, legal frameworks need to be suitably adapted to their profiles and needs, empowering retail investors and enhancing their participation in capital markets, while at the same time ensuring adequate levels of protection.

By striking the right balance between improving investor protection, providing investors with adequate investment opportunities and avoiding unnecessary red tape for the financial industry, a level playing field for all financial services can be ensured.

The Retail Investment Strategy is also being developed against the backdrop of Europe's digital transformation and technological innovation. Financial services and retail investor protection must adjust to the rapid evolution in the way financial services interact with their clients and the way retail clients take decisions when it comes to investing, while ensuring that no one is left behind.

The EFR also strongly believes that, to increase the trust of retail investors, ambitious public policy initiatives are required, ranging from work on financial education and financial literacy to how information is disclosed. According to Eurobarometer results, 86% of Europeans say they feel confident in managing their personal finances. However, the results vary across Member States, gender, age, and level of education – showing the need for continued attention to financial literacy, the enhancement of which was rightly set as one of the key actions in the European Commission's CMU 2020 action plan.

#### 1. Digital-by-default – allowing for disclosure in a digital format, while customers who still want paper can request it

The upcoming EU Retail Investment Strategy represents an opportunity to adapt EU retail disclosure rules and conduct regulation to the digital age and empower customers to make informed investment decisions. The covid-19 crisis has demonstrated the importance of digital communication for business continuity, and has increased customers' expectations with regard to paperless transactions.

Seen against that background, existing retail investment rules should be adapted to promote a more digital-friendly approach. For instance, Article 23 on Information conditions of the Insurance Distribution Directive (IDD) and Article 14 of the Packaged Retail Investment and Insurance-based Products (PRIIPs) Regulation on Provision of the key information documents should be revised to avoid the use of paper as a default requirement for the provision of information. Nevertheless, in order to leave no one behind, customers who feel the need to obtain a paper copy should still have this alternative option, on request.

Such a digital-by-default approach could enable financial providers to present information in a more intuitive and understandable way e.g., informative visuals. With digital support, investors could better navigate through pre-contractual information and target more easily the type and amount of information they wish to have access to, thus reducing information overload concerns. However, this entails implementing

sufficiently flexible rules, to develop a future-proof and technology-neutral approach. For instance, digital formats must take account of the fact that customers will navigate through documents on a smartphone or a tablet, while table structures or A4 document format are often difficult to read when using these devices. The development of more interactive and understandable digital disclosure documents should therefore be supported by the use of techniques such as layering and cross-referencing through hyperlinks.

More broadly, digital channels are not only a means to tackle the issue of investors receiving too much paper, but also as an opportunity to identify new ways of further engaging with customers. For instance, digital channels can simplify onboarding processes and ease access to customers' profiles, via digital dashboards. Ultimately, this approach will help to democratise financial knowledge and financial advice, while supporting better product development through customer feedback.

## 2. Disclosure

EFR Members are continuously working to improve their customer disclosure documents and channels to make them as user-friendly as possible. They value feedback received from customers and use those insights actively. Furthermore EFR Members noted with interest the finding of the Kantar Study[3] that customer information, although largely compliant with existing legislation, is not appealing enough and too complex to effectively capture customers' attention.

With that in mind, EFR Members would urge policymakers to ensure that customers are not overloaded with new disclosures and that any proposed updates to disclosures are tested with consumers to ensure they are effective. More is not always better, as the PRIIPS Key Information Document (KID) shows: the KID should not become longer or more complex by adding new elements without removing old/obsolete elements at the same time or by requiring additional (complex) sets of numbers and projections, all of which could unintentionally undermine its purpose.

EFR Members also support EIOPA's work on the mapping of duplicative disclosure requirements as published in its April 2022 advice on the Retail Investment Strategy. Eliminating duplications and inconsistencies is key to avoiding customer confusion and helping to ensure information is clear and easily understood.

Finally, improved disclosure alone is insufficient to reliably foster customer understanding and empowerment. In addition to engaging with retail customers via digital channels, increased investment in financial education, as recommended in the EFR report on financial inclusion (July 2022), is a fundamental requirement and would not only foster customer understanding but could help gain customer attention.

## 3. Inducements as a key element in the Retail Investors' Strategy

The role of inducements has been at the very centre of the discussion around the upcoming Retail Investment Strategy, with the suggestion from some quarters that the only way to resolve perceived conflicts of interests would be to ban inducements altogether. The EFR sees such an approach as neither necessary nor conducive to supporting an expansion of retail investment in Europe. On the contrary, it would likely result in the impoverishment of the financial services made available to most European households and would ultimately go against the very objective of the CMU to route European savings towards the financing of the EU real economy.

3 Disclosure, inducements, and suitability rules for retail investors Study published by the European Commission on 22 July 2022.

The premise for such a ban on inducements is inaccurate. Customers are not 'locked' into a single relationship with their bank. They often have multiple banks and are able to buy financial products on online platforms or from independent wealth-management advisers, and they do so. If they use their bank, it is by choice. Similarly, banks also offer financial products outside their group (open architecture). Consumers also have the possibility to buy insurance-based investment products through their insurance agent, or financial adviser, with the possibility to shop around, and they would not be charged for advice if they do not buy a product, because the adviser is paid on a commission-basis. The Kantar report shows this multiplicity of competing offers. There is no market failure. This competitive aspect and customers' freedom of choice are essential.

Banning inducements would be a regulatory distortion of competition. It would favour the model of specialised banking and brokerage over universal banking, which offers its customers a full range of financial services in a single institution. Regulations must accept and respect all models and be neutral in this regard, especially since universal banking is the most widespread model in continental Europe.

As clearly showed by the Kantar Study, customers value advice, and yet a blanket ban on inducements would deprive many consumers of access to that advice. Section 6.5.7. of the Kantar Study provides evidence on the impact of the inducement ban in the UK and in the Netherlands. In the case of the UK, the study acknowledges that an advice gap has emerged with many investors now finding investment advice unaffordable, and a significant number of banks advising high-income investors only. The FCA's FAMR 2018 baseline survey showed that 4.5 million UK adults took regulated financial advice over a 12-month period. A further 18.2 million had £10,000 or more in savings and/or investments and might have needed advice – but did not take it. In the case of the Netherlands, the study reports that the share of retail investors receiving investment advice has decreased after the ban on inducements was adopted, and advice is now only available for existing clients or clients above a certain level of wealth. In addition, in its technical advice on inducements under MiFID II, ESMA[4] notes that a ban could result in the establishment of a closed architecture, leading to a reduction rather than increase in the overall level of retail investment and failing to reflect the diversity of EU local markets with one-size fits all[5]. A ban on inducements would create the risk of an advice gap, particularly for those retail investors with lower amounts available to invest. Since investments always compete with other (seemingly more attractive) uses of the funds, in particular immediate consumption, the pension gap may be widening substantially, especially for financially weaker consumers. A recent KPMG[6] report highlights that retail investors with less than €100,000 available to invest would not have access to advisory services neither in the Netherlands nor in the UK where inducements have been banned. In those markets, it is now evident that the vast majority of investors are reluctant to pay explicit fees for the advice received[7]. In the UK[8], the FCA has recently consulted on ways of broadening access to financial advice and is expected to implement a new regime within a year.

4 See paragraphs 35 and 36 in the Final Report dated 31 March 2020 on ESMA's Technical Advice to the Commission on the impact of the inducements and costs and charges disclosure requirements under MiFID II. ESMA does not recommend to the Commission to ban inducements completely for all retail products across the Union - https://www.esma.europa.eu/sites/default/files/library/esma35-43-2126_technical_advice_on_inducements_and_costs_and_charges_disclosures.pdf

5 Final Report dated 31 March 2020 on ESMA's Technical Advice the Commission on the impact of the inducements and costs and charges disclosure requirements under MiFID II https://www.esma.europa.eu/sites/default/files/library/esma35-43-2126_technical_advice_on_inducements_and_costs_and_charges_disclosures.pdf

6 https://hub.kpmg.de/the-future-of-advice

7 Investment Trends, Europe Advice Accessibility Report (July 2021).

8 FCA evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review (December 2020), demonstrates that:
   1. On the demand side, only 8% of the UK adult population had access to regulated financial advice (figure 2.2 pp 10).
   2. On the supply side, 40% of firms have formal minimum investment limits, starting at £50,000 and around 10% of firms only deal with clients with £1m (figure 2.5, pp 39).

We have not yet seen clear evidence or robust independent assessment showing that paying fees for advisory services (explicit fees) would lead to better outcomes for retail investors than fees linked to products (inducements). On the contrary, the same KPMG report shows that a customer who invests €50,000 in a mixed fund would pay 7% less with inducements in the first year than with the explicit fees model.

We are not starting from scratch. Consumers are protected by regulations (MIFID Directives 2014 and 2016 as well as IDD), which ensure that they are well informed by clear and non-misleading information. The regulations also ensure the quality of the advice, the ratio between remuneration and the substance of the advice, the availability of varied and competitive financial products, appropriate to the customer's needs, including those offered by third parties, transparency of remuneration, etc.

To encourage more retail participation in our capital markets, address the financial literacy gap and ensure our distribution models deliver fair outcomes for investors, we recommend maintaining both fee and commission-based distribution models, while looking at further improving transparency for consumers so that costs and charges are clearly described and are easily understandable and at the same time ensuring that products that are being put on the market offer value for money as a whole, through enhanced Product Oversight and Governance processes as envisaged by EIOPA in its recent publications on value for money.

Finally, the EFR would like to stress that regulatory consistency and convergence between proposals aimed at improving the protection of retail investors is essential. Any new proposal should be aligned with ESMA and EIOPA initiatives concerning the suitability assessment.

## 4. Value for Money

EFR Members are committed to providing long-term, sustainable value to their clients in order to meet their savings and investments needs.

The EFR recognises that the issue of Value for Money has become an important element of the Retail Investment Strategy, taking into account what matters most to customers, the total cost of a product in relation to its benefits and how they match a customer's needs.

From the outset, it is important to recognise that the issues of Value for Money and inducements merit importance in their own right and should not be automatically linked. In this regard, the Kantar Study noted that the MiFID regime has not (yet) resulted in a market where consumers receive better value for money through lower inducements.

While noting that the concept of Value for Money is not formally present in the applicable regulation, the overall adequacy of the product for the client's needs is a crucial element to ensure that outcome. Hence, a product that incurs higher costs, may still be better value for money than a lower cost product, because the benefits, including those beyond pure investment return, are also greater and/or better fit a customer's needs. As an example, such benefits may include capital protection or ESG features. Supervisors would exceed their powers if they were to try to limit the number of underlying investment options of unit linked and hybrid products, thus restricting consumers' choice.

Also, the current MiFID2 and IDD framework caters well for consumer protection. Product design and testing as per Product Oversight and Governance (POG) rules, professional advice, distributors' continuous training, suitability / appropriateness / demands and needs tests, transparency requirements and product monitoring already ensure a high level of consumer protection through the entire life cycle of a product. Having said that, EFR members stand ready to discuss ways to further enhance the principles embedded in the current framework since, in some specific instances, further improvements to Value for Money may be required. In this regard, the EFR welcomes the recent EIOPA methodology on Value for Money as it can create greater supervisory consistency and predictability through objective KPIs. We note, however, that greater consideration could be paid to the level of risk coverage of the product for the customer, including the existence of financial guarantees, life risk coverage or risk mitigation techniques and, where pertinent, the integration of ESG preferences.

Value for Money should not focus solely on costs, neglecting the wide range of different qualitative and quantitative features of unit-linked and hybrid products. Moreover, it is important to consider the total cost of distribution when assessing whether a product offers appropriate Value for Money.

## 5. Client categorisation

MiFID II can be overly restrictive for certain types of sophisticated clients with experience of the financial markets. Such clients are classified by default as 'retail' under the current rules, constraining the services and products that can be made available to them, particularly taking into account ESMA guidelines[9] on appropriateness and execution-only requirements. This is detrimental to the client's long-term investment goals and also to the goal of encouraging more investment through the capital markets in Europe's SMEs and corporates, which would help to build the Capital Markets Union.

We do not believe it is necessary or desirable to create a fourth category of 'semi-professional' client. Instead, it would be preferable to refine the opt-up criteria applicable within the existing MiFID II investor protection framework when a retail client elects to opt-up to professional status, so as to provide access to a larger product universe, also through removing the link between client categorisation and asset class.

This could be achieved on the basis of an objective and verifiable test. For example, **both the following two criteria** would need to be fulfilled by a client in order to be eligible to opt up:

a) **Wealth Criterion:** the client holds net assets to the value of €5m or more (excluding main residence and pension plan assets). This would provide more flexibility to clients with a substantial asset base beyond their everyday needs, allowing them to take higher risks; and

b) **Expertise Criterion:** the client has actively taken investment decisions covering at least 3 asset classes; OR has recent professional experience (assessing/reviewing/trading financial products) for a minimum of 5 years to cover at least one economic cycle including exposure to investment risk in market stress, ensure understanding of the interdependence for markets for different asset classes and financial instruments, and ensure expertise remains valid at the point of opting up. Alternatively, the client has a relevant professional qualification (e.g. CFA).

9 ESMA Guidelines on certain aspects of the MiFID II appropriateness and execution-only requirements.

## 6. Personal Investment Plan

The European Commission is assessing the merit of a "personal investment plan" (PIP) as part of new investor-centric assessments to improve the current suitability and appropriateness (S&A) tests. It is envisaged that this potential PIP will come on top of existing S&A assessments and operate across investment products, currently regulated in MiFID and IDD, with a view to attaining optimal diversification of various asset classes. The transferability of the client assessment would be a key element of the PIP.

While there may be some room for improvement of the current S&A regimes, we would dispute the merit of the PIP on top of the S&A assessments for the following reasons:

a) **"One size fits all" fails to acknowledge the different needs and types of retail investors**
The existing framework has been designed to serve retail clients with different investment needs. In the absence of details on the interdependency between the PIP and the S&A, the effective role of the former in the advisory process may be called into question. In particular, we would dispute a potential precedence and pre-emptive effect of the PIP over the S&A assessments.
To apply a standardised PIP that no longer discerns across various investment services on top of the S&A might raise questions of whether a "one size fits all" approach can effectively serve all the different types of retail investors and situations[10].
From an insurance angle, the implied interchangeability of Insurance Based Investment Products (IBIPs) with any investment product ignores the unique features of both types of products, which is the basis for the existence of distinct regulatory frameworks. In particular, the PIP tends to focus on return maximisation and overlook important elements of IBIPs e.g. protection and guarantees, as well as the value of insurance not generally captured by an investment return.

b) **Challenges around transferability and intermediary liability**
The transferability of the PIP may create liability risks for the intermediary, hindering the envisaged free sharing of such data. Mandatory data sharing could also lead to a reduced availability of advice ("advice gap") on account of the intermediary performing the initial assessment facing "free riding" from other intermediaries on the assessment.
Furthermore, supervisory experience has shown resistance from clients to share personal information such as investment history/transaction data due to different factors, e.g. lack of trust and fear of cyber risks[11], which may call into question a key element of the PIP.

c) **Reduced knowledge and competence of people involved in distribution**
A key target of the framework is to ensure adequate knowledge and competence of the people involved in distribution (IDD recital 31 and MiFID II recital 79). Product-driven regimes (help) elevate the standard of advice as they demarcate and hence increase the knowledge and competence provided in the assessment by placing an object (product range) in perspective with the subject (consumer). In other words, the more focused the scope of the assessment, the easier it is to improve it as well as ensure that it indeed matches the needs of the customer (see section a). We would therefore dispute the merit of an approach that looks to broaden the boundaries of the assessment to attain higher levels of professionalism and competence of intermediaries.

10 ESMA letter to EU Commission on consultation options to enhance the suitability and appropriateness assessments (13 April 2022).

11 ESMA letter to EU Commission on consultation options to enhance the suitability and appropriateness assessments (13 April 2022).

## EFR recommendations – EFR call for action

The EFR welcomes initiatives to empower retail investors and foster their participation in the EU capital market. The Retail Investment Strategy is a critical opportunity to achieve these goals and modernise regulation.

A fundamental step towards the success of the capital markets union is to improve the financial literacy of EU citizens. Financial illiteracy prohibits people from planning for their future and making informed decisions about what to do with their money. Over-indebtedness, excessive risk-taking, and vulnerability to fraud are possible consequences that exacerbate the risk of financial exclusion[12].

Digitalisation has the potential to make financial services more inclusive. Accordingly, existing retail investment rules should be adapted to promote a digital-by-default approach. A digital-by-default approach would enable financial providers to present information in a more intuitive and understandable way. In general, the Retail Investment Strategy is an opportunity to make customer disclosure documents and channels more user-friendly, eliminating duplications and inconsistencies.

In addition to improved information, expert advice contributes to customers' awareness of available investment options and potential risks. We take note of the discussions concerning inducements but have not yet seen clear evidence of any robust and independent assessment showing that paying fees for advisory services (explicit fees) would lead to better outcomes for retail investors than fees linked to products (inducements). To encourage more retail participation in our capital markets, address the financial literacy gap and ensure our distribution models deliver fair outcomes for investors, we recommend maintaining both fee and commission-based distribution models, while also looking at further improving transparency for consumers so that costs and charges are clearly described and are easy to understand.

The Retail Investment Strategy can contribute to ensuring a broad and diverse range of products that offer value for money and cater to the financial needs of citizens and society. The EFR recognises that value for money has become an important element of the Retail Investment Strategy, taking into account what matters most to customers, i.e. the total cost of a product in relation to its benefits and how they match a customer's needs. The current IDD framework caters well for consumer protection. Improvements in terms of greater supervisory consistency and predictability may be required, building on the EIOPA's methodology on Value for Money.  Notwithstanding this, value for money should not narrowly focus on costs as this would neglect the wide range of different qualitative and quantitative features of unit-linked and hybrid products.

When it comes to client categorisation, the EFR believes that MiFID II can be overly restrictive for certain types of sophisticated clients with financial markets experience. The EFR recommends refining the opt-up criteria applicable within the existing MiFID II investor protection framework.

Finally, the EFR takes note of the European Commission activities in relation to assessing the merit of a "personal investment plan" (PIP). We would dispute the merit of the PIP as a “one size fits all” fails to acknowledge the different needs and types of retail investors. Also, the transferability of the PIP may create liability risks for the intermediary, hindering the envisaged free sharing of data.

The EFR stands ready to engage on the broad range of issues at stake, from digital transformation to cross-sector consistency, expert advice, and financial literacy.

12 EFR Position paper on Financial Inclusion: 143-1-efr-paper-on-financial-inclusion.pdf

# 2. Tackling the Huge Financing Needs of the European Economy fit for both transitions

## Introduction

European policymakers need to address two seemingly incompatible challenges in delivering the sustainable finance, digital and energy transitions:

1. There are vast financing needs, which the Governments will not be able to fund alone.
2. The current lack of depth to European capital markets and the trend of increasing capital requirements make it difficult for the financial sector to play its usual role.

Consequently, if the policymakers wish to deliver on the promises they have made to the people of Europe, they must endeavour to address those issues that currently constrain the financial sector in meeting these vast financing needs. A focus on achieving genuinely open European capital markets with harmonised standards and rules would contribute to the success of the Capital Markets Union (CMU), which could also serve as one of the top global destinations for capital investment needed.

While the EU has made some progress on the CMU Agenda, a number of issues have not yet been fully addressed. Focusing on a true revival of securitisation would already be an important step. There should be a focus on initiatives that will help mobilise the large reserves of private savings / pensions for long-term investment. A common framework for insolvency should be established, given that insolvency laws are among the most crucial bottlenecks preventing the integration of capital markets in the euro area and beyond.

### 1. European Financing Needs

Geopolitical tensions and the health and climate crises have led to a wide consensus in Europe on the need to strengthen its resilience and sovereignty and to achieve the green and digital transitions. Addressing these challenges and meeting the very significant related financing needs will entail continued reforms to Europe's economic growth and financing models. The EU estimates that the additional annual investments needed for the EU's green and digital transition over the next decade amount to €650 billion[13] per year. These figures surpass the trillion euro per year mark for the combined region of the EU, UK and EFTA countries, especially if defence investment is to reach 2% of GDP and industrial resilience is also factored in. To put these numbers in perspective, it is worth noting that EU bank loans to all households and non-financial corporations amounted to some €500 billion[14] for the year 2021, which represents less than half of the additional annual investment required.

Although the public sector has an essential role to play in this challenge, the bulk of this financing will have to come from private sources. This will require a financing system that is as accessible, interconnected and efficient as possible, allowing capital flows within Europe to become more fluid between savers, investors, the financial system and companies. Enhancing private capital flows will mean tapping into the full potential of Europe's private savings and further enabling securitisation, which unfortunately remains greatly underdeveloped, despite the regulatory reforms of recent years. Additional measures aimed at completing the CMU as well as improving the regulatory framework to enhance liquidity and the functioning of financial markets are necessary. Lastly, crosscutting policies in the areas of taxation and competition would also help to improve the business environment and attract the investments needed to successfully achieve Europe's

13 EC report "Towards a green, digital and resilient economy" March 2022.

14 EBF Facts & Figures 2022 - 2021 banking statistics.

political priorities. In reaction to the US Inflation Reduction Act, the EC presented on 1 February 2023 a Green Deal Industrial Plan to enhance the competitiveness of Europe's net-zero industry and support the fast transition to climate neutrality. The Plan aims to provide a more supportive environment for the scaling up of the EU's manufacturing capacity for the net-zero technologies and products required to meet Europe's ambitious climate targets. While this Plan contains important proposals it is not enough to enhance the competitiveness of the European financial sector.

In recent years, Europe has shown that it can be a world leader in capital market activities related to ESG, with debt issuance reaching €360bn in 2021, a six-fold increase from 2017. This has been made possible by ambitious policies and strategies, as well as the introduction of landmark regulations at EU and national levels. The EFR believes that policy makers have to deploy the same level of ambition for the full development of capital markets in Europe in order for the transformation of the European economy to succeed.

However, further increasing capital requirements for banks may limit their financial capacity and the finalisation of Basel III will reduce this capacity by roughly 20%. The impact study for this reform, published by the Basel committee in February 2022, shows a 300 bp reduction in the CET1 ratio of large banks in Europe. Clearly, the overarching principle of the 2017 Basel accord of no significant increase in capital requirements is not being respected. The European Commission's proposal to implement this reform includes temporary alleviations, but, fully loaded, the overall impact will be around the figure calculated by the Basel committee. Copenhagen Economics, an independent think tank, evaluated that this significant increase in capital requirements would reduce the financing capacity of European banks by roughly €3000 bn.

## 2. Capital Markets Union

When it was first launched in 2015, the CMU initiative was based on the need to change the European economy's financing model by giving financial markets a bigger role, taking into account the increasing restrictions that the reinforcement of the prudential framework was imposing on bank lending. Its basic aim was to diversify the EU's financing sources and create a truly Single Market for capital. This objective to build deeper and more integrated EU financial markets remains all the more valid at a time when the EU faces growing financing needs to ensure Europe's decarbonisation, digital transformation and energy transition.

While the CMU would be seen as an obvious goal for the European Single Market because it should be so logical for European policymakers to accomplish this together, the reality is very different. Although the EC has made many proposals to push for a CMU, the EU is unfortunately still facing a quasi-non-existent CMU. In addition to this, the EU is facing a lack of risk-taking culture, which translates into risk adverse, and largely non-productive, allocation of European households' savings. Finally, fragmentation in regulation and supervisory approaches pose a threat to the efficiency and integrity of EU and global financial markets.

All the arguments made over the years in many reports by the EFR and others concerning the importance of establishing the CMU remain valid. In this chapter, we will focus on just a few of them.

Alongside these themes, we note that the EU Retail Investor Strategy discussed in the previous chapter offers a valuable opportunity to mobilise European savings for the CMU, which can also strengthen this.

The EFR calls for political leadership to make the CMU a reality and urgently address the issues that are raised by the EFR in this Chapter, since, without a CMU, funding the huge financing needs will be an uphill battle. In the EU, there should also be also a shift towards growth-supporting measures. Non-risk sensitive regulations should be avoided. It is time to take a holistic look at the current regulatory frameworks and determine whether it suits what Europe needs to support economic growth and its competitiveness. Similarly, all new rules must work consistently and coherently to support the growth objective.

### 3. Securitisation

Securitisation was identified by the European Commission in 2020 as one of the key actions to complete the CMU. As European financing needs cannot wait, we should now focus on solutions that we know can work quickly towards the establishment of a CMU - such as facilitating securitisation as an indispensable tool to develop capital markets as well as finance the digital transformation and energy transition.

The EFR therefore calls for action to make securitisation an effective instrument for the European financial sector so that savings and assets under management of institutional investors (pension funds, insurance companies, asset managers, etc) can be mobilised and used to invest in Europe instead of other jurisdictions such as the USA.

In the EFR Paper on Securitisation of January 2023, we indicated that the average annual funding flows (credit loans, debt and equities) to residents of the eurozone amounted to €460 billion[15] between 2015-2019 and that covering the needs related to the energy transition would imply somewhere between a doubling and a tripling of the annual flows of European funding.

Since the European financing needs should be covered by both market and credit financing, the EU is still a long way off target. As an example, in December 2021, outstanding green bonds reached more than €500 billion in the EU compared to around €150 billion in 2018 (+266%). ESG funds outstanding amounted to €1.4 trillion versus around €600 billion in 2018 (+133%). Despite their sustained growth, green bond issues still make up only a small proportion of all bond issues (around 4% of all corporate bond issues in 2020 in the EU).

Compared to the USA, the European market for securitisation is very narrow: securitised assets represent only 8% of the eurozone GDP, compared with 47% in the U.S. Even excluding the U.S. agency securitisation market, which represents 70% of the total U.S. market, the U.S. private market is still twice that of the EU.

The persistently lower level of issuance volumes in Europe, following the Global Financial Crisis (GFC), reflects a loss of confidence in securitised products, despite their very resilient credit performance in Europe through the severe economic downturn triggered by both the GFC and the subsequent Eurozone crisis, with considerably fewer defaults than expected compared to the U.S. and an improvement in overall credit quality: the share of securitisations with an investment grade rating had risen to 96% by Q2 2021, compared to 93% in 2014.

We can no longer afford to neglect funding sources with such potential because there is an irrational stigma attached to this. In this context, it is important to note that, since 2010, CRD3 prevents the "exotic securitisations" that led to the 2008 crisis.

15 Average annual net funding flows mobilised by euro area resident agents between 2015 and 2019 (source: ECB; calculation: BNP PARIBAS): Net issuances of debt market (commercial paper, bonds) = €230 billion; Change in outstanding bank loans to euro area residents = €178 billion; Annual net flows of listed share issues = €47 billion.

Another key reason for the low securitisation volumes is the limited risk sensitivity in the EU regulatory treatment of securitisations, for both banks and investors such as insurers. Conversely, the U.S. did not implement the revisions to the securitisation framework issued by the Basel Committee in July 2016.

The Final Basel III standard, currently implemented via amendments to the EU prudential framework (CRR III), will make securitisation even less attractive. In that context, a financial tool such as securitisation which allows banks to free up their balance sheets to provide more credit to their clients, is indispensable. Targeted changes are needed to ensure EU securitisation does not become even less attractive as a result of the Final Basel III implementation.

During the low-interest rate period, large institutional investors were less interested in buying securitised products because the yields were too low. With rising interest rates and higher yields, these products are likely to become attractive to institutional investors (pension funds, insurance companies, asset managers). Assurance on those products is also provided through the retention rate that is laid down in the EU securitisation framework.

For smaller and mid-sized European insurance companies which need a minimum amount of diversification of their portfolios, the possibility of buying securitised products might also offer a welcome opportunity for investment.

Nevertheless, to enable investors to buy securitised products, banks should be accommodated in order to sell them.

To unlock the potential of the European securitisation market, the EU framework needs to be revised to make securitised assets more attractive to issuers (banks) and investors, in particular by recalibrating the prudential treatment of European securitisation exposures to better reflect their high quality. As outlined in the joint paper produced in December 2022 by the French Trésor and BMF on priority changes to the securitisation framework, although fundamental changes of the regulatory framework may not be opportune in the short term, short-term fixes to securitisation regulation within CRR3, Solvency II, ESMA templates and the European Green Bond Standard (EUGBS), as well as further work at the Basel Committee should be considered "as a matter of urgency."

### 4. The review of MiFID 2 / MiFIR and the related risks on the effectiveness of European markets for the financing of the economy

The publication by the European Commission (EC) of its draft proposal for the **review of MiFIR**, in November 2021, raised strong concerns amongst EU market participants:

- while generally welcome, both as a tool to further unify EU markets and a way to limit the strong inflation in the cost of market data, the proposal to create a Consolidated Tape (CT) was met with some scepticism, as the operational perimeter envisaged by the Commission (post-trade only CT for shares) may not answer enough use cases to make it viable,
- the proposal to ban Payment For order Flow, i.e. situations where dealers pay retail brokers or banking networks to execute the orders from their clients, triggered fierce debates about the concept of best execution for retail investors,
- with regard to shares, the EC proposed limiting the access to alternative venues of execution, by further constraining the activity of systematic internalisers and by restricting the ability to use

waivers to pre-trade transparency. The underlying intention was to redistribute flows within the Union for the benefit of historical regulated markets. Still, in a context where non-EU market participants represent a significant share of volumes and since UK authorities have clearly expressed their will to increase the attractiveness of London, the proposal mostly had the potential to favour the emergence of alternative pools of liquidity for EU shares in the UK and to trigger a diversion of liquidity from the Union to the UK,

- with regard to non-equity instruments, and specifically to bonds, the EC intended to increase transparency by harmonising and shortening the authorised deferral to make the executed transactions public, also on illiquid instruments or large sizes. Again, since the bond market relies on the intervention of liquidity providers that need sufficient confidentiality regarding their positions, and while UK authorities appear to have no intention to follow the same path as the EC, the proposal would have created an incentive for bond market participants (both liquidity providers and investors) to move their business to the UK.

While the two first issues remain strongly debated, discussions in the ECON committee and at the Council level on equity and non-equity market structure issues tend to indicate that both the Parliament and Member States are willing to limit the negative impact of the review on the competitiveness of EU market structure. More generally, **EU co-legislators seem to be gradually taking into account the impact of their decisions on the attractiveness of EU markets, and the need to factor in the evolution of regulation in the UK**.

With regard to the **review of MiFID 2**, for which the European Commission proposal is expected in H1 2023, the first indications given in the frame of the Retail Investment Strategy have raised the concern that the European Commission may be contemplating the introduction of an outright **ban on inducements** (see chapter on retail investment strategy). This **would create an advice gap and ultimately discourage EU retail investors from participating in capital markets**.

In this context, EU investment solutions manufacturers and distributors are advocating an alert against the negative impact of an inducement ban, and the proposal of alternatives based on (i) a more systematic assessment of the value of financial products, (ii) an increase in the quality of services provided to investors and (iii) the enhancement of competition and transparency on the data providers' market.

### 5. Tax treatment

Overall, European households have very considerable savings, but relatively little of this is invested in longer term or riskier financial instruments, with retail investor participation in capital markets remaining very limited in most European countries. This is due in part to structural factors but also to cultural reasons, such as a general preference for bank deposits and low-risk short-term products. Another important factor, however, is the biased tax treatment of savers' capital gains and dividends in many Member States, which discourages households, and their fund managers, from participating in the market. In this regard, there is little that can be achieved at EU level given that tax policy remains strictly a national competency. Member States, however, can individually create incentives and a more advantageous tax treatment for households to increase their participation in capital market products for their long-term savings and pension needs. This should be coupled with initiatives to better educate consumers and improve access to quality financial advice, also in the area of sustainable products for which there is large demand from savers. The European Commission's upcoming "retail investment package" provides an opportunity for the EU to address this key issue.

## 6. Competitiveness

The EU should as a general rule ensure that measures taken in the EU do not create global competitive disadvantages for the European financial sector.

Cooperation and coordination at global level is vital for the competitiveness of the EU. One of the key messages of the EFR has always been that internationally operating financial groups based in Europe benefit from global standards that provide added-value to their customers through efficiency gains and increased competition as a result of an international level playing field. Furthermore, open EU borders should be ensured in order to be attractive for international (financial) institutions.

### Competitiveness under stress

The EFR Paper entitled "Ensuring the competitiveness of the European financial sector" of April 2022 gave an overview of the factors that placed the competitiveness of European banks under considerable stress over the last decade. It was explained that this is due to a narrower, less profitable and highly competitive "domestic" market, a US market organised to the benefit of US banks, and an unfavourable prudential development for European banks compared to US banks, following a more brutal impact of the 2008 crisis for the latter.

- The "fully phased-in" level of the Basel III framework clearly induces a significant distortion between European and US banks, to the detriment of the former; it is noticeable that the stronger requirements imposed on European banks are not linked to lower levels of capital that would need to be corrected (see for instance BCBS Basel III Monitoring Report, December 2020, page 26), but rather to the difference in the structure of balance sheets: compared to US banks, which benefit from a deep (and government-supported) securitisation market, European banks keep large pools of low-risk assets in their balance sheet, which are penalised under the "fully phased-in" Basel rules. It should also be noted that FRTB (Fundamental Review of the Trading Book) rules favour more developed capital markets, and hence thwart the ambition to develop the market activities of European banks.

- EU banks' market revenues rely on a still immature and fragmented market where they face increasing competition from US investment banks, which can rely on a deeper, more profitable and more concentrated domestic market. Additionally, later adaption of the monetary policy and higher risk of recession on this side of the Atlantic translate into less favourable perspectives for EU banks compared with their US peers.

- The development and current supremacy of US banks in market activities was primarily enabled by the fact that – contrary to Europe – the US constitutes a unified legal, regulatory, fiscal and, in some areas, infrastructure framework. However, US reforms undertaken in the 70s and the 80s were also critical in enabling the consolidation of banks and the emergence of champions in the Corporate & Investment Banking (CIB) area.

- The profitability indicators of European and US banks, both globally and limited to the CIB activities, clearly show the stall of the former.

- The market share of the different banks in the Investment Banking market in Europe have followed divergent paths (in the geographical sense EMEA: EU-27 + UK + Switzerland + Middle East and Africa, IB market being DCM, ECM, M&As and syndicated loans).

- According to the Refinitiv league tables, the market share of US banks has grown very significantly since 2010, first on the back of the weakening of other non-EU-27 banks, and more recently to the detriment of EU-27 banks. It is notable that this market share gain accelerated in 2021. The return to better fortunes of European institutions hides the fact that, in relative terms, US banks have seen their European business grow very quickly.

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It was stressed that the achievement of open strategic autonomy in the area of financial markets requires ensuring that the attractiveness of EU financial markets and the competitiveness of EU financial market participants remain a cornerstone of the EU's financial strategy. These attractiveness and competitiveness considerations need to be integrated into every aspect of the legislative work of the Union in relation to financial markets so as to account for the diverse needs of EU investors and corporate companies, to raise capital (equity listing, private equity, bonds, etc.), invest (funds, structured products) and hedge risks (OTC derivatives). With this in mind, EFR particularly welcomes the mid-December publication by the European Economic and Social Committee of its Opinion on the introduction of a Competitiveness Check that should be "mandatory, effective and fully enforced at each stage of the decision-making process" and "be a key part of balanced EU decision-making" "to support enterprise, job creation and improved working conditions, as well as sustainable economic growth and social cohesion". It should cover legislative initiatives, secondary legislation, fiscal measures, strategies and programmes, as well as international agreements.

It is especially crucial that the European legislative and regulatory proposals for the financial sector support rather than hamper the global competitiveness of the European financial sector (in the implementation of Basel III as well as in the on-going review of Solvency II for instance), foster the deepening of EU financial markets (CMU initiative, securitisation market, etc.), favour rather than limit the emergence of European champions and enable efficient deployment of the available capital in the markets.

American public authorities systematically evaluate the economic and competitive impact of their decisions. It is high time to introduce a systematic competitiveness check of EU policies.

### Regulatory regimes

The global market share of European banks has been declining over the years, which is in part due to regulatory and policy measures taken by EU institutions. While the financial crisis rightfully prompted structural reform and new regulatory measures, nearly 15 years after its occurrence, European financial regulation is heavily focused on risk and insufficiently oriented towards growth.

Regulatory regimes need to be fit for purpose so that banks and insurers can support the growth of the real economy and finance the energy and technological transition. Nevertheless, the prudential framework needs, while remaining robust, to allow for such a role. Any increase in regulatory capital requirements would further raise capital costs for European headquartered groups, impeding their external growth and reducing their ability to support the real economy.

Proposals concerning the supervisory regimes should therefore avoid triggering any significant increase in capital requirements, ensuring that there is no negative impact on bank and insurance capital available and European financial institutions' competitiveness. Both the specific characteristics of the European banking environment and the international context – the way other jurisdictions implement agreed requirements – should be taken into account to ensure a level-playing field and maintain alignment as far as possible, including on timing, with other major jurisdictions.

**Digital transformation and sustainable finance transition**

Furthermore, financial services firms must be able to compete fairly when European rules concerning the digital transformation and the sustainable finance transition are being implemented.

- In terms of the digital agenda, it is important to foster a diverse range of innovative services for citizens and businesses, as well as support the adaptation of industries like financial services to the digitalisation of ecosystems. Regulation should promote fair competition in the interests of customers and ensure that customers continue to have access to a diverse choice of financial services from a range of providers. It is important to ensure a balance between competition and innovation on the one hand, while also keeping high standards in terms of investor protection. Regulation should be technology-neutral and apply the same rules to the same risks, recognising that new market dynamics created by rapid technological change have blurred sectoral boundaries.

- Concerning the sustainable finance agenda, an appropriate scope of EU sustainability regulation should be aimed at making sure that EU standards do not imply distortion of competition between EU and non-EU financial institutions. They should take account of the specific challenges and difficulties that both EU and non-EU headquartered financial institutions will face in reporting information and implementing their due diligence obligations on their operations and business partners in third countries where companies will not be subject to (equivalent) EU sustainability disclosure requirements in the short/medium term. Given the global nature of the stakes attached to green transition and climate change, international cooperation is critical, especially in the reporting area, where globally harmonised mandatory ESG disclosure standards, with core KPIs that are common across sectors and jurisdictions are much needed.

## 7. Differences in insolvency laws and their application should be addressed

A focus on achieving genuinely open European capital markets is important and a further integrated European capital market with harmonised standards and rules is urgently needed. Corporation and insolvency laws need to be aligned and similarly applied. However, in the EU, major differences in insolvency laws and significant differences in their application between the Member States continue to be a major obstacle to investment across borders. Therefore, although very complex to implement, proposals for a European framework to harmonise insolvency regimes and shorten the length of court proceedings are also urgently needed. While the EC has drawn up some proposals, they are still not sufficient to meet investors' concerns.

On 22 November 2016, the European Commission proposed a Directive for harmonisation of insolvency rules, which was presented as one of the key deliverables under the CMU Action Plan. In December 2018,

the Council and the European Parliament reached an agreement on the Directive. While, at the time, the EFR welcomed the Directive to harmonise insolvency frameworks at European level, we noted that the Directive does not harmonise core aspects of formal insolvency procedures such as conditions for opening insolvency proceedings, definitions of insolvency or ranking of claims. The Directive focused more on rather common principles and rules. The EFR observed that the Directive does not provide adequate protection to secured creditors. Creditors, banks and investors, should play a more decisive role in insolvency proceedings, starting from a very early stage, as their participation can produce new solutions or additional funding ultimately allowing companies to restructure their debt in a timely, flexible and cost-effective manner. Furthermore, the Directive does not go far enough in providing incentives for creditors willing to grant new or ongoing financing to companies in need of liquidity. While the EU has made an effort to address some issues on insolvency rules via the Directive, the end-result is more of a dis¬appointment, since we are still a long way from true harmonisation of insolvency law.

As announced in the new CMU Action Plan, the EC proposed new rules concerning Corporate Insolvency on 7 December 2022 with the aim of fostering cross-border investment across the Single Market, lowering the cost of capital for companies and ultimately contributing to the EU's CMU. While the EFR welcomes the proposals and the efforts undertaken by the EC, the main concerns of investors have still not been fully addressed.

Taking into account the long-standing aim of the EFR to establish a CMU and given the huge European financing needs in the coming years, the harmonisation of insolvency rules is indeed very important from an investor perspective. Legal certainty is an absolute basic requirement for each institutional investor in order to invest cross-border. Different national insolvency rules and significant differences in the length of insolvency court proceedings represent a key obstacle to cross-border investments, on account of internationally operating investors having to build up the complex legal expertise of each individual national legal system in their own legal department or buy this expertise from outside.

It would be good to already look now at other solutions in parallel with the focus of the EC in its Action Plan. Given long-standing difficulties in harmonising insolvency regimes in Europe, one option could be to create an opt-in regime, a system governed by Community law, along the principles of the EU legislation concerning the Societas Europaea (SE). This would be a truly pan-European Insolvency regime. We realise that the adoption of such a regime will require unanimity of the Member States. In line with various proposals to strengthen the Monetary Union, a good option could be to propose such an opt-in possibility for a pan-European Insolvency regime for the Monetary Union which could be a first realistic step towards harmonisation and maybe a benchmark for further measures.

## 8. Private Public Partnerships (PPP)

Across the entire European Union, there is an urgent need to catch up on investments for the modernisation of infrastructure. There is also agreement that the already highly indebted public sector is not able to finance these enormous amounts alone. Private investors in the financial sector stand ready to make their contribution to closing these financing gaps.

However, the procedures for implementing PPP projects are regulated very differently in each EU Member State. While, in some parts of the EU, PPP projects can be agreed in an unbureaucratic way, multi-stage official approval procedures have to be gone through in other countries. This extreme level of bureaucracy has a prohibitive effect and thus prevents the participation of institutional investors.

It seems all the more important to involve private investors in PPP projects in an unbureaucratic way. This requires a European framework that regulates the main features of PPP processes. Long-term oriented investors from the areas of banking, private equity, insurance and pension funds would be willing to make their contribution to the sustainable modernisation of highways, bridges, utility lines and other infrastructure areas. Certainly, the expected return on investment should be adequate for the risk structure. However, in view of the end of the multi-year phase of low interest rates in the euro zone, the option of alternatively financing infrastructure investments by issuing government bonds can only be realised at significantly rising costs. It is also beyond dispute that private investors, thanks to their organisational and legal expertise, can contribute to accelerated implementation and cost reduction of infrastructure projects.

## EFR Recommendations

- To tackle the vast financing needs of the European economy, the EFR calls for political leadership to make the CMU a reality.

- The current lack of depth to European capital markets should be addressed by:

  - focussing on a true revival of securitisation, which should be made an effective instrument for the European financial sector so that savings and assets under management of institutional investors can be mobilised and used to invest in Europe; the EU framework needs to be revised to make securitised assets more attractive to issuers (banks) and investors, in particular by recalibrating the prudential treatment of European securitisation exposures to better reflect their high quality;

  - focussing on initiatives that will help mobilise the large reserves of private savings / pensions for long-term investment;

  - establishing a common framework for insolvency by working towards a harmonisation of insolvency regimes and shorten the length of court proceedings; in parallel to focus on creating an opt-in regime, a system governed by Community law, along the principles of the EU legislation concerning the Societas Europaea (SE), which would constitute a truly pan-European Insolvency regime;

  - creating incentives by Member States and a more advantageous tax treatment for households to increase their participation in capital market products for their long-term savings and pension needs; this should be coupled with initiatives to better educate consumers and improve access to quality financial advice, also in the area of sustainable products for which there is large demand from savers.

  - encouraging the further development towards a European framework that covers key elements of public-private-partnerships processes, so that long-term oriented investors from the areas of banking, private equity, insurance and pension funds can further strengthen their contribution to the sustainable modernisation of high-quality, future-driven infrastructures. This is also important in the context of last year's Council regulation[16] regarding a framework to accelerate the deployment of renewable energy projects, which we welcome.

16 Proposal for a Council Regulation laying down a framework to accelerate the deployment of renewable energy dated 19 December 2022. https://data.consilium.europa.eu/doc/document/ST-16238-2022-INIT/en/pdf

- ensuring that for all legislative and regulatory proposals – such as a.o. the review of MiFID 2 / MiFIR – the impact of EU co-legislators' decisions on the attractiveness of EU markets is being taken into account and a systematic competitiveness check is introduced as recommended in the opinion of the EESC of 14 December 2022[17].

- All new rules must work consistently and coherently to support the growth objective and the competitiveness of the European financial sector; for this there should be a shift towards growth-supporting measures; non-risk sensitive regulations should be avoided.

- Achievement of open strategic autonomy in the area of financial markets requires ensuring that the attractiveness of EU financial markets and the competitiveness of EU financial market participants remains a cornerstone of the EU's financial strategy.

17 European Economic and Social Committee: Reference: INT/1000-EESC-2022-EESC-2022-03972-00-00-AC-TR.

# 3. Meeting Digitalisation challenges

## 3.1 Central Bank Digital Currencies

### Introduction

As stated by the ECB[18], the success of the digital euro depends on the usefulness and benefits received and perceived by all the players involved, i.e. end users, intermediaries and merchants. Indeed, to succeed this project needs the participation of all stakeholders.

EFR Members agree with this statement and are willing to cooperate with the ECB and other relevant authorities to ensure that the digital euro project adds value to the European economy and consumers. The reason for this is that, for the time being, the financial sector has not been entirely convinced by some of the conceptual options already endorsed by the Governing Council of the ECB. Notably, the opening of hundreds of millions of accounts in the ECB balance sheet and the development of a public payment scheme by the ECB have far-reaching consequences.

Banks are at the core of payment services and would play a key role in bringing the digital euro closer to citizens and businesses. Although we do welcome the organisation of consultations by the ECB on this design of the digital euro, we would like to see real involvement of stakeholders in the ECB design choice. A close public-private partnership between EU authorities and market participants is essential for the successful development of the digital euro.

The ECB has so far prioritised use cases that are already covered by existing payment solutions, including those based on instant payments, which EU policymakers are indeed promoting. Therefore, with the project as it currently stands, it is unclear what added-value a digital euro would provide for the end users and how private and public solutions would complement each other. We welcome the aim of the ECB not to crowd out private solutions.

In any case, if finally issued for the prioritised use cases, there are some core design features of a digital euro that we believe would be essential for its success and to prevent undesirable effects: 1) the role of intermediaries in the distribution of the digital euro and 2) the need for a robust business model and a clear and easy-to-implement legal framework with fair competition between different payment options; 3) the accessibility of data from digital euro transactions, 4) the tools to prevent excessive holdings of digital euros, and 5) the security features to prevent fraud and foster AML, as well as 6) a customer centric vision in overall terms.

#### 1. Core design options

##### Distribution model

- The distribution model of the digital euro endorsed by the Governing Council of the ECB is a payment scheme with common rules for intermediaries that ensure a homogeneous end-user experience, with the ECB developing and controlling such a scheme.

18 Fabio Panetta, Ulrich Bindseil, Ignacio Terol: Occasional paper nº 286 / December 2021 "Central Bank Digital Currency: functional scope, pricing and controls"
https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op286~9d472374ea.en.pdf?2dfe373fb889c60a88fa65393caa5255

- In our view, however, the formula for a successful payment scheme lies in the correct allocation of responsibilities and incentives between the public and private players. Governance of the scheme needs to be clear with a clearly defined decision-making power for each type of participant.

- Banks and other payment services providers could be well positioned to develop the end-to-end payment services based on a digital euro, given our long and proven experience in the retail payments space, and the knowledge we have about customer needs.

- We therefore call on the ECB to focus its work on the basic functioning of the digital euro and allow intermediaries to build payment solutions on top of it. This would allow the digital euro to be integrated into existing payment solutions and infrastructures in order to make its deployment and provision as efficient as possible. Additionally, enhanced competition may enable intermediaries to innovate and offer users value added services.

- The ECB on the other hand could focus entirely on mitigating the major operational and cyber risks for the Eurosystem, created by the holding of hundreds of millions of accounts.

### Business model

- Intermediaries would need a sustainable business model. They will have to recover the costs plus a margin for the setup and maintenance of the digital euro and the provision of related services (onboarding, KYC, fraud, security, transaction authentication, user support, provision and update of devices and technology needed to pay in physical stores, etc.) included for those end users who are not or cannot be customers of the same intermediaries. The ECB has not yet clarified the cost of the complex new infrastructures to be built, who is going to bear these costs, and what the new sources of income to cover these costs would be.

- Public-private cooperation is paramount to build a fit-for-purpose payment scheme and define fair compensation for intermediaries. In our view, there should be free competition in the provision of payment acquisition services to merchants and payment initiation for users, as is currently the case with other payment solutions, and a viable business model for the intermediaries should also exist.

- There should be a level playing field and fair competition between the digital euro and other payment solutions in order to preserve an open, competitive and diversified payments market.

### Data

- Data privacy and data protection are a top concern for citizens. For this reason, access to payments data by financial intermediaries is currently governed by frameworks such as the GDPR, AML and PSD2, with these regulations ensuring that current electronic payment solutions already provide very high privacy standards.

- The ECB has floated the idea that certain digital euro transactions could be granted a higher degree of privacy. However, it is crucial that intermediaries, to the extent they are involved in the circulation of the Digital Euro, have access to payment transaction data in the same way that they currently do for other digital payment means in order to fulfil their legal compliance obligations and build more effective tools to protect users from fraud.

- In addition, payment data is key for the provision of financial services as well as for the development of innovation in finance. The end users should, upon their consent, be allowed to share their payment data and decide whether this can be used for different purposes, such as the offering of personalised, value-added services. This would be consistent with the EU priority of promoting data-driven innovation, also in the financial sector.

### Holding cap

- To avoid undesirable effects on financial intermediation and stability as a result of the shift of bank deposits to a digital euro (eg. unexpected outflows, limiting the resources available to banks to finance the economy), the ECB is considering two different tools to limit the take-up: a quantitative cap to the digital euro holding per individual, and a two-tiered remuneration structure, in which holdings exceeding a certain threshold would be disincentivised.

- In our view, the only effective option, as well as the easiest to be understood by citizens, is to set a hard cap on individual users' holdings of digital euros. The alternative of a tiered remuneration system would add unnecessary complexity and uncertainty, and would ultimately not be effective in times of crisis when customers look for the safest asset and are not price sensitive.

- The limits should be calibrated to cover day-to-day basic payments and take account the financial stability implications of the associated shift of commercial bank deposits for financial stability. According to the latest survey by the ECB on consumer payment attitudes, people in the euro area possessed an average of €83 in their wallet. In addition, if we look at the share of payments by value range, only 4% of payments in the POS and 11% in ecommerce had a price tag higher than €100[19]. Usability as a means of payment for larger transactions would not be affected by the limit on holdings thanks to a waterfall account mechanism.

- The hard cap should be stable over time and only be changed under clear, predefined conditions. It should be set by the ECB following principles/rules established in the legal framework and should be the same for every country.

## 2. Process aspects to be taken into account

- Another concerning issue is the time frame envisaged by the ECB to make a decision on whether to move from the investigation phase to a realisation phase: depending on the timeline of the digital euro bill (the EC is expected to make a proposal on May 2023), the realisation phase could begin before the co-legislators have set a position on this.

- Clarity on the legal framework is essential before moving forward with the realisation of a digital euro, given that the legal framework is expected to set the conditions for key design aspects, including the data protection/AML framework or the eligibility criteria and obligations for intermediaries.

19 Study on the payment attitudes of consumers in the euro area (SPACE) December 2022
https://www.ecb.europa.eu/stats/ecb_surveys/space/html/ecb.spacereport202212~783ffdf46e.en.html

## EFR recommendations

- As with the introduction of euro banknotes and coins in 2002, a CBDC will only be a success if all stakeholders are fully convinced of its usefulness.
- Banks should be actively involved in the discussions on the digital euro, both at the strategic and technical level, as pivotal players for the deployment of the digital euro.
- Beyond a customer centric vision, five core design aspects require special attention: the allocation of duties between the ECB and the intermediaries, a robust business model based on fair compensation concerning costs, privacy and data issues, the preservation of financial stability, financing of the economy and a flourishing and diversified European payments eco-system, as well as the security features to prevent fraud.
- A level playing field between public and private payment solutions is key.
- The ECB and EU policymakers should align the timing of their respective contributions to a successful launch of a Digital Euro.
- The EFR and its members are at the disposal of authorities to engage in such relevant debate.

### 3.2 Digital Sovereignty

## Introduction

Geopolitical tensions and experience from Covid-19 have highlighted the dependencies on international supply chains in many parts of the world economy. In Europe, this has created a policy focus on strategic autonomy. Where data storage and processing are concerned, the goal is now to bolster the EU's "Digital Sovereignty". Various concrete policy proposals and initiatives have been launched to this end.

As an example, we see increased calls for data localisation requirements in technical initiatives such as the Cybersecurity Certification Scheme for cloud services (EUCS). At the same time, there is active support for the development of new EU-based solutions, such as a European digital identity scheme, new European payment systems supported by the issuance of a Digital Euro, or new data infrastructures like the cloud.

We understand and support the EU's wish to bolster its strategic autonomy and digital sovereignty.

However, we would like to point out that the lack of unified interpretation at European level of what digital sovereignty is and how it can be achieved might end up creating fragmentation in the approach to increase digital sovereignty and the required implementation of legal and technical solutions.

Digital sovereignty should not be understood as erecting new barriers to international cooperation or having to build separate EU-only infrastructures from scratch. As a result of such an approach, European market participants could lose access to high-end technology, which would hamper innovation, competitiveness and even security. These unintended consequences of that understanding of "digital sovereignty" should be avoided.

Instead of limiting "permitted" technology providers to those located in the EU, 'digital sovereignty' should be understood as the ability for companies to independently choose the digital technologies they use, how to use them and who to partner with. In order to achieve digital sovereignty, it is important to create a consistent, innovation-friendly regulatory framework supporting innovation made in Europe as well as collaboration with established players from inside and outside the EU. This will also increase access to funding enabling European businesses to compete and grow – both across the EU and in the global market.

The aim of the EFR with this paper is to contribute to the debate on digital sovereignty, with particular focus on a number of ongoing initiatives: namely the ENISA work on a European Cybersecurity Certification Scheme for cloud services, the new EU-US Transatlantic Data Protection Framework and industry initiatives concerning so-called "Sovereign Clouds" and the Data Act.

## 1. New EU-US Data Privacy Framework

Following the invalidation of the EU-US Privacy Shield by the European Court of Justice in July 2020, EU public authorities have paid more attention to the risk of access to EU personal data by foreign authorities, resulting in a push towards digital sovereignty. The publication of recommendations from the European Data Protection Board, new standard contractual clauses by the European Commission or Binding Corporate Rules have helped EU organisations transferring EU personal data to the United States to cope with legal uncertainty. However, in the absence of a new EU-US free data flow agreement, compliance concerns have remained vis-à-vis the provisions of the General Data Protection Regulation.

Seen against that background, the EFR welcomes the implementation of the new EU-US Data Privacy Framework aimed at addressing the concerns expressed by the European Court of Justice through limiting access to EU personal data by US intelligence authorities and establishing an independent and impartial redress mechanism. Once implemented, this agreement is expected to provide legal certainty the urgently needed not only for organisations relying on adequacy decisions for international data transfers, but also for those using other tools, such as standard contractual clauses and binding corporate rules.

Clear rules concerning data management are even more critical for international companies leveraging new technologies, such as financial services providers. Given the cross-border nature of data and digital tools, political or regulatory decisions affecting how data can be stored and transferred create significant challenges for companies wanting to adopt global approaches for digital processes, as well as a competitive disadvantage for EU firms aiming to develop an international presence. In more specific terms, data sovereignty approaches can hamper efforts from financial services to leverage Cloud services technologies, increasing operating costs and hindering the scalability of global services. Combined with data analytics or artificial intelligence solutions, cloud services technologies are a precondition for the financial services industry to not only compete, providing better service to its customers and improving its operational excellence, but also increase security and resilience.

## 2. A European Cybersecurity Certification Scheme for cloud services – EUCS

In 2019, the EU Cybersecurity Act was adopted by the co-legislators in the EU, with the aim of creating a harmonised framework for European cybersecurity certification for products, processes and services. The goal of this regulation was to strengthen the single market and facilitate the use of technology across Member States.

As part of their mandate, the European Union Agency for Cybersecurity (ENISA) is currently working on a European Union Certification Scheme for Cloud Services, known as EUCS. The on-going discussions on preconditions to reach the highest certification level propose far-reaching control and localisation measures not only for the service, but also the providers: i) data must be physically located in the EU; ii) the global headquarters of the cloud service providers (CSPs) must be located in the EU; iii) non-EU shareholders may not control the CSP (neither directly nor indirectly, individually, nor jointly); and iv) the staff supporting the service must be located in the EU.

At national level, France announced its intention in 2021 to develop a "trusted Cloud" label for European-based entities fulfilling specific security requirements associated with the SecNumCloud technical reference from the National Cybersecurity Agency of France (ANSSI). This label also includes data protection criteria in relation to the extraterritorial reach of non-EU laws. This initiative has resulted in the launch of US cloud services providers and partnerships of European firms, with the objective of deploying "Trusted Cloud" offers in 2023.

Although the EFR supports the strive for greater independence from a limited number of non-European providers, it is questionable whether the options considered are aimed in the right direction and even if they are achievable at all – and at what cost. This question is particularly relevant given that the originally voluntary nature of EU certifications could become a binding requirement under Article 24 of the recently adopted Network and Information Security Directive (NIS 2).

Introducing such far-reaching localisation requirements may effectively prevent the non-European CSPs from being able to meet these requirements and providing their services wherever the assurance level "high" is required. As NIS 2 allows for the development of delegated acts outlining additional sectoral requirements, this may be the case for all critical services under NIS2. It is also our understanding that these requirements would apply throughout the entire value chain of a particular service, for example in the case of software-as-a-service solutions that are deployed in the cloud.

As a result, these sovereignty requirements will simply have the opposite effect to those intended in the scheme, actually preventing companies from using the most efficient, secure, innovative, and competitive cloud services. Access to innovation will be limited for European financial services providers, with negative implications for agility, international competitiveness, profitability and even security if financial sector companies had to choose services and providers based on their location instead of the quality of their services – directly contradicting the original objective of the Cybersecurity Act.

## EFR recommendations

- When assessing the way forward on digital sovereignty, it will be important to consider a significant number of different perspectives. Current initiatives often focus on a single objective, such as cybersecurity or data privacy. They do not take sufficient account of the implications that measures have on other objectives, including innovation or competitiveness, nor the effects caused by existing market structures. For example, cloud multi-vendor requirements may fail to reduce lock-in in an oligopolistic cloud market. At the same time, reliance on just a few providers is an important component of reducing vendor complexity. It is therefore important to bring all the perspectives together, as the different goals may be complementary, mutually enforcing or, in contrast, conflicting.

- The on-going process launched by the European Commission for the adoption of an adequacy decision for the EU-US Data Privacy Framework has the potential to introduce greater legal certainty for EU firms transferring data to the US. For that purpose, EU authorities must ensure that this new agreement effectively addresses concerns expressed by the European Court of Justice, in order to avoid a third invalidation.

- EFR Members encourage EU and US public authorities to enhance their cooperation in order to design consistent frameworks for the development and deployment of new technologies. In that regard, the discussions undertaken in the context of the Trade and Technology Council are a constructive step to drive digital transformation based on common values.

- Political ambitions and technical considerations should neither be unduly mixed, nor should technical assessments be ignored. Whereas localisation of data and infrastructure or even legal organisations is often considered as a tool to retain control over data, technical measures to ensure security do not always receive sufficient attention. In other words: having data stored physically in the EU does not automatically make it more secure against unauthorised access or even loss nor does it really solve the concentration risk. In addition, in a global context, data localisation requirements present a particular challenge in this regard, with significant costs being incurred by companies operating internationally and even possibly increasing the exposure to cyber and operational risks. The goal should always be to implement the least intrusive measures to achieve the shared objectives of cyber security and resilience.

- Sovereignty and freedom of choice are the results of competition and market offering. The focus of policy actions should be on creating an innovation-friendly regulatory and legal framework in the EU in order to encourage and facilitate investments in IT developments. It is necessary to increase the market offering rather than limiting access to technology based on the provider's location.

- The EFR encourages public authorities to harmonise, when possible, and make more consistent rules across different jurisdictions. Otherwise, it will become increasingly difficult for organisations and companies to navigate across these various legal regimes and remain compliant. Ultimately, it will have a negative impact on the ability of financial services providers to leverage datasets and new technologies for the benefit of customers.

- The EFR encourages EU authorities to adopt a proportionate approach to shape "digital sovereignty" ambitions by balancing considerations concerning personal data protection and the competitiveness of EU firms. Financial institutions must remain able to freely design their own cloud strategy and, in particular, choose their cloud providers in order to have access to the business value of Cloud technologies as long as providers comply with existing rules that guarantee both cyber security and data privacy.

# ANNEX I: EFR VISION

The European Financial Services Round Table (EFR) was set up in 2001. The Members of EFR are Chairmen and Chief Executive Officers of international banks or insurers with headquarters in Europe.

EFR Members believe that a fully integrated EU financial market, a single market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services across the Member States of the European Union. An open and integrated market reflecting the diversity of banking and insurance business models will support investment and growth, expanding the overall soundness and competitiveness of the European economy.

Increased fragmentation as a result of the post-crisis regulatory response underlines the need to safeguard the single market and protect the level playing field. The EFR therefore strongly encourages national governments and the EU institutions to continue their efforts to create a truly single market for wholesale and retail financial services, which will play an essential role in providing long-term financing for the economy in Europe. Furthermore, strong market discipline is essential to ensure fairness and alignment of interests of the financial sector and the rest of the economy towards serving the citizens of Europe and the world.

The integration of financial markets does not stop at the EU's borders – markets are increasingly global. EFR Members therefore encourage both national and European leaders to establish internationally consistent and coherent financial regulation and supervision and to support and promote free and open markets throughout the world.

As of March 2023, EFR Members' companies combined represent

- Around 957 million customers[20]
- Around 2.05 million employees
- €23.31 trillion total assets
- €21.55 trillion assets under management

20 Please note that double counting of customers may occur.

## EFR Members as of 1st March 2023

**Jean Lemierre**
EFR Chairman and
Chairman
BNP Paribas

**Michel Liès**
EFR Vice-Chairman and
Chairman of the Board
Zurich Insurance Group Ltd.

**Oliver Bäte**
Chairman of the Board of Management
Allianz SE

**Lorenzo Bini Smaghi**
Chairman
Société Générale

**Edward Braham**
Chairman
M&G

**Philippe Brassac**
Chief Executive Officer
Crédit Agricole SA

**David Cole**
Chairman of the Supervisory Board
NN Group

**William Connelly**
Chairman of the Supervisory Board
Aegon NV

**Sir Howard Davies**
Chairman
NatWest Group

**Sergio Ermotti**
Chairman of the Board of Directors
Swiss Re Ltd.

**Héctor Grisi**
Chief Executive Officer
Banco Santander

**Antoine Grosset-Grainville**
Chairman of the Board of Directors
AXA

**Stephen Hester**
Chairman
Nordea

**Nigel Higgins**
Chairman
Barclays

**Antonio Huertas Mejías**
Chairman and CEO
MAPFRE

**Colm Kelleher**
Chairman
UBS

**Axel Lehmann**
Chairman of the Board of Directors
Credit Suisse Group

**Pietro Carlo Padoan**
Chairman of the Board of Directors
UniCredit Group

**Steven van Rijswijk**
Chairman of the Executive Board and CEO
ING Group

**Andrea Sironi**
Chairman
Assicurazioni Generali S.p.A.

**Carlos Torres Vila**
Chairman
BBVA

**Mark Tucker**
Group Chairman
HSBC

**Alex Wynaendts**
Chairman of the Supervisory Board
Deutsche Bank AG

# ANNEX III: EFR PAPER ON SECURITISATION

## Introduction

European policymakers need to address two seemingly incompatible challenges in delivering the sustainable finance, digital and energy transitions:

1. There are vast financing needs, which the Governments will not be able to fund alone.
2. Without proper securitisation, which is an important step towards a Capital Markets Union, it will be difficult to meet the financing requirements.

Consequently, if the policymakers wish to deliver on their promises that they have made towards the European population, they must endeavour to address the important topic of securitisation.

## European Financing needs and Funding

Current estimates are that between €600 billion[21] and €1 trillion in additional annual financing would be needed in the EU to meet the carbon neutrality objectives by 2050. These estimates significantly exceed the amounts foreseen under the "Investment Plan for a Sustainable Europe" presented by the European Commission in January 2020 (€100 billion per year for 10 years from five different sources of funding[22]).

In comparison, the average annual funding flows (credit loans, debt and equities) to residents of the eurozone amounted to €460 billion[23] between 2015-2019. Covering the needs related to the energy transition would therefore imply between a doubling and a tripling of the annual flows of European funding.

European financing needs should be covered by both market and credit financing. Nevertheless, we are still a long way off target. As an example, in December 2021, outstanding green bonds reached more than €500 billion in the EU compared to around €150 billion in 2018 (+266%). ESG funds outstanding amounted to €1.4 trillion versus around €600 billion in 2018 (+133%). Despite their sustained growth, green bond issues still make up only a small proportion of all bond issues (around 4% of all corporate bond issues in 2020 in the EU).

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21 In a survey ("State of the Union: Questions & Answers on the 2030 Climate Target Plan", 17 September 2020) the Commission estimated that the 55% reduction of GES by 2030 would require financing of around €350 billion per year in energy systems. Moreover, the deficit in financing needs and sustainable investment is estimated at between €100 and 150 billion per year and financing needs in "social investment" (to support the transition) at €142 billion.

22 The five sources of funding for the "Green Deal" are, over a period of 10 years:
- the reallocation of existing funds from the EU budget to 'green' projects amounting to 500 billion,
- 114 billion in co-financing by the Member States,
- 279 billion in public and private funding mobilised under the InvestEU programme set up by the previous Commission led by Jean-Claude Junker,
- €25 billion in carbon market revenue (from the Modernization Fund financed by a fraction of the revenue from the European carbon market - emissions trading - separate from the EU budget),
- Just Transition Fund: €7.5 billion allocated by the EU with the aim of raising public and private funding of at least €143 billion over 10 years

23 Average annual net funding flows mobilised by euro area resident agents between 2015 and 2019 (source: ECB; calculation: BNP PARIBAS): Net issuances of debt market (commercial paper, bonds) = €230 billion; Change in outstanding bank loans to euro area residents = €178 billion; Annual net flows of listed share issues = €47 billion.

## Securitisation

The envisaged European Capital Markets Union (CMU), whose aim is to diversify the financing sources and uses and create a truly Single Market for capital, has not yet been established. As Europe's financing needs cannot wait, we should now focus on solutions that we know can work quickly towards a CMU - such as facilitating securitisation.

Securitisation is an indispensable tool to develop capital markets as well as to finance the energy transition. Securitisation was identified by the European Commission in 2020 as one of the key actions to complete the CMU.

Compared to the USA, the European market for securitisation is very small: securitised assets represent only 8% of the eurozone GDP, compared with 47% in the U.S. Even by excluding the U.S. agency securitisation market, which represents 70% of the total U.S. market, the U.S. private market is still twice that of the EU.

The persistently lower level of issuance volumes in Europe, following the Global Financial Crisis (GFC), reflects a loss of confidence in securitised products, despite their very resilient credit performance in Europe through the severe economic downturn triggered by both the GFC and the subsequent Eurozone crisis, with considerably fewer defaults than expected and an improvement in overall credit quality: the share of securitisations with an investment grade rating had risen to 96% by Q2 2021, compared to 93% in 2014.

We can no longer afford to neglect funding sources with such potential, because there is an irrational stigma attached to it. In this context, it is important to note that:

- European securitisations have proven to be far safer than American ones (with default rates immensely lower) before 2008.
- Since 2010, CRD3 prevents "exotic securitisations" which had led to the 2008 crisis.

Another key reason for the low securitisation volumes is the lack of risk sensitivity in the EU regulatory treatment of securitisations, for both banks and investors such as insurers. Conversely, the U.S. did not implement the revisions to the securitisation framework issued by the Basel Committee in July 2016.

The Final Basel III standard, currently being implemented via amendments to the EU prudential framework (CRR III), will significantly increase the amount of capital banks need to hold. At the same time, the Output Floor and its use of the Standardised Approach for banks' Risk Weighted Assets (RWA) calculations will make securitisation even less attractive.

In that context, a financial tool such as securitisation which allows banks to free up their balance sheets to provide more credit to their clients, is indispensable. Targeted changes – as detailed in the Annex - are needed to ensure EU securitisation does not become even less attractive after the Final Basel III implementation. These changes are possible already through the ongoing CRR III process. During the low-interest rate period large institutional investors were less interested in buying securitised products because the yields were too low. With rising interest rates and higher yields, these products are likely to become attractive to institutional investors (pension funds, insurance companies, asset managers). Assurance on those products is also provided through the retention rate that is laid down in the EU securitisation framework.

For smaller and mid-sized European insurance companies which need a minimum amount of diversification of their portfolios, the possibility of buying securitised products might also offer a welcome opportunity for investment. Further, the LCR treatment of securitisations should be enhanced and aligned with that of covered bonds, enabling greater participation by banks as senior investors.

Nevertheless, to enable investors to buy securitised products, banks should be accommodated in order to sell them.

To unlock the potential of the European securitisation market, the EU framework needs to be revised to make securitised assets more attractive to issuers (banks) and investors, in particular by recalibrating the prudential treatment of European securitisation exposures to better reflect their high quality.

## Conclusion

While often in international meetings - as well as in bilateral meetings - policymakers and politicians agree that securitisation could play an important role, no significant action has been undertaken mainly due to the stigma that is attached to it.

Therefore, the EFR calls for that action in order to make securitisation an effective instrument for the European financial sector so that savings and assets under management of institutional investors (pension funds, insurance companies, asset managers, etc) can be mobilised and used to invest in Europe instead of other jurisdictions such as the USA.

# ANNEX

Targeted changes to ensure EU securitisation does not become even less attractive after the Final Basel III implementation.

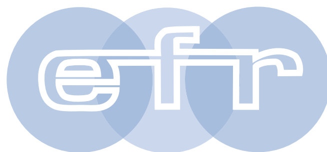
A good start would be to reduce the negative impact of the introduction of the output floor on the economic viability of securitization in CRR3. This could be achieved by a recalibrating the Standardised Approach (SEC-SA) through the reduction of the "p factor" in CRR Art. 261-262 by half.

That is needed, because with the CRR III Output Floor, both the reference securitised pool RWA and tranche level RWA will increase, through the use of the Standardised Approaches. An uneconomically high increase of the SEC-SA will reduce banks' ability to manage credit risk through securitisations. Conversely, the U.S. Simplified Supervisory Formula Approach (SSFA) applies a p factor of 0.5. Another change is needed in the Internal Ratings Based Approach (IRBA). Currently the framework applies a risk weight (RW) floor of 10% for Simplified, Transparent and Standardised (STS) securitisations, and 15% for non-STS (CRR Arts.259-260). After the GFC, regulatory reforms have reduced securitisation risks, for instance through risk retention requirements for originators, enhanced credit underwriting standards (Mortgage Directive), ongoing monitoring of securitisations by supervisory authorities, investor due diligence requirements and performance reporting. These changes justify lowering the RW floors.

A proposal would be to reduce also for Sec-IRBA the level of calibration of the so called "p" factor (representing the relative capital surcharge for the securitisation exposures compared to the capital requirement for the underlying pool) and the RW floors by 1/3 for STS and non-STS. For STS, the adjustment would allow the floor to be set at around the previous floor under the Supervisory Formula Approach (SFA). But in the EU non- STS transactions are twice as many as STS ones, so the equivalent change would need to apply also to non-STS and for all bank roles, i.e., originator, investor and sponsor, to ensure consistency in the risk sensitivity.

## ANNEX IV: ABBREVIATIONS

| | |
|---|---|
| **ANSSI** | Agence nationale de la sécurité des systèmes d'information |
| **AML** | Anti Money Laundering |
| **BCBS** | Basel Committee on Banking Supervision |
| **CBDC** | Central Bank Digital Currency |
| **CFA** | Chartered Financial Analyst |
| **CIB** | Corporate & Investment Banking |
| **CMU** | Capital Markets Union |
| **CRD** | Capital Requirements Directive |
| **CRR** | Capital Requirements Regulation |
| **CSPs** | Cloud Service Providers |
| **CT** | Consolidated Tape |
| **DCM** | Debt Capital Markets |
| **EC** | European Commission |
| **ECB** | European Central Bank |
| **ECM** | Equity Capital Markets |
| **ECON** | (European Parliament's) Committee on Economic and Monetary Affairs |
| **EFR** | European Financial Services Round Table |
| **EFTA** | European Free Trade Association |
| **EIOPA** | European Insurance and Occupational Pensions Authority |
| **ENISA** | European Union Agency for Cybersecurity |
| **ERT** | European Round Table for Industry |
| **ESG** | Environmental, Social and Governance |
| **ESMA** | European Securities and Markets Authority |
| **EU** | European Union |
| **EUCS** | European Cybersecurity Certification Scheme for Cloud Services |
| **EUGBS** | European Green Bond Standard |
| **FAMR** | Financial Advice Market Review |
| **FCA** | Financial Conduct Authority |
| **FRTB** | Fundamental Review of the Trading Book |
| **GDP** | Gross Domestic Product |
| **GDPR** | General Data Protection Regulation |
| **GFC** | Global financial Crisis |
| **IBIPS** | Insurance-based investment products |
| **IDD** | Insurance Distribution Directive |
| **IMF** | International Monetary Fund |
| **KID** | Key Information Document |
| **KPIs** | Key Performance Indicators |
| **KYC** | Know Your Customer |
| **M&A** | Mergers and Acquisitions |
| **MiFID2** | Markets in Financial Instruments Directive 2014 |
| **MiFIR** | Markets in Financial Instruments Regulation |
| **NIS** | Network and Information Security Directive |
| **PIP** | Personal Investment Plan |
| **PPP** | Private Public Partnership |
| **PRIIPS** | Packaged Retail Investment and Insurance-based Products |
| **POG rules** | Product Oversight and Governance |
| **PSD2** | Payment Service Directive 2 |
| **S&A** | Suitability and appropriateness |
| **SE** | Societas Europaea |
| **SME** | Small and Medium Enterprise |
| **UK** | United Kingdom |
| **USA** | United States of America |
| **WEF** | World Economic Forum |
| **WEO** | World Economic Outlook |

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