SwissFinanceCouncil

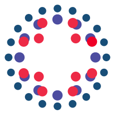
Fostering International Dialogue

MEMORANDUM

The EU and its Partners

Defending Open Markets in Challenging Times

24 February 2015, Concert Noble, Brussels

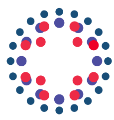


Introduction by
Alexis Lautenberg, Chairman, Swiss Finance Council

Mr Lautenberg warmly welcomed participants and said that the Swiss Finance Council is a platform of two global institutions – UBS and Credit Suisse – anchored in a non-EU neighbouring country. There is no blueprint or precedent from which inspiration has been drawn; they are proceeding in uncharted quarters. The launch of the Swiss Finance Council has been timed, said Mr Lautenberg, to coincide with the launch of new undertakings, such as the Capital Markets Union, which is a huge opportunity that includes a third-country dimension that deserves to be tackled in a way that maximises the outcome for everyone concerned. He pointed out that the discussion paper being presented is the result of cooperation between chief economists of the two stakeholders and an external advisor, J. Llewellyn. He closed by saying that he hoped this event will be the first of a series along these lines.

Keynote speech by
Olivier Guersent, Deputy Director General, DG Financial Stability, Financial Services and Capital Market Union, European Commission

Mr Guersent considers it is timely to discuss the EU and its partners, after the recent wave of regulatory reforms in the financial industry in Europe. He said that the main challenge facing Europe is the implementation of the 40 regulations that the Commission has proposed and which the Parliament and Council have adopted over the last five years. These are designed to reconcile the imperative for growth, the need for financial stability, and the requirement to have a consistent framework in which markets can operate in a well-regulated – but not over-regulated – way. He described the three priorities of Lord Hill as European Commissioner for financial stability, financial services and capital markets union: enforcement of the 40 regulations, the launch of the Capital Markets Union, and to continue work towards international convergence and cooperation. Mr Guersent said that Europe's engagement with key international partners is critical to achieve stability and coherence in financial services regulation. He emphasised that the Capital Markets Union is a single market project for all 28 Member States, with a strong international dimension, to make the European market better and more attractive to foreign investment. He pointed out that the EU attracts a fifth of the world's international investments; and suggested that there is some margin to improve this.



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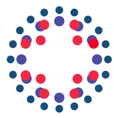
Presentation of the discussion paper 'The EU and its Partners: Defending Open Markets in Challenging Times'

John Llewellyn, Partner, Llewellyn Consulting

Reinhard Cluse, Managing Director and Chief Economist for Europe, UBS

Dr Llewellyn gave an overview of major-economy GDP growth over the past 130 years. He described how the economic performance before 1945 of the country group known today as the G7 was quite volatile, whereas the period afterwards has been much steadier, with only one major fall in GDP (following the financial crisis from which the Western world is only just starting to emerge). He also highlighted that the growth of Western economies in the aggregate had been trending downwards ever since the 1960s; and that performance deteriorated further following the 2008 crisis. Typically, following a financial crisis, GDP falls by about 10% relative to its (extrapolated) trend, and investment by around 30%; and the recent crisis fits this broad pattern. Furthermore, when the economy recovers, the gap is generally not closed: GDP growth returns only slowly to its pre-crisis rate, not least because investment is usually very slow to recover. Moreover, GDP seldom regains its (extrapolated) pre-crisis level. Dr Llewellyn finished by showing that, seven years on, the economic recovery from the 2008 crisis is not yet complete, investment in many Western countries still being below its previous peak. This suggests two strong reasons for wanting to see strong capital flows: to maximise economic growth; and to link Europe more closely to parts of the world that are faring rather better.

Mr Cluse stated that the EU is still after several years of crisis suffering from weak growth, very high divergences in GDP growth, and negative inflation. This means that Europe for many years to come will experience constraints from a hefty debt burden, in both the public and private sectors. He also said that Europe is suffering from a high rate of unemployment of 11.5% across the Eurozone; a figure which masks even higher figures in certain Member States. Europe is therefore facing an economic, social and political challenge, with the integrity of the monetary union at risk. The EU banking sector has suffered, and this has caused major damage to the EU economy for two reasons: banks are the key source of corporate funding in Europe, and the crisis of the banks has hit the SME sector particularly hard. However, the Banking Union was launched and has made good progress that should contribute to economic healing. Mr Cluse said that Europe should not stand still, and looked forward to the Capital Markets Union, the aim of which, he said, is twofold: to establish alternatives to bank funding, and to create more efficient, growth-friendly and fully integrated capital markets in Europe. His final point about CMU was that it will improve access to funding, which will be a huge step forward.



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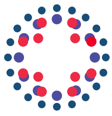
Oliver Adler, Managing Director and Head of Economic Research, Credit Suisse AG

Judith Hardt, Managing Director, Swiss Finance Council

Mr Adler showed some charts displaying the extent of EU trade with the external world, and pointed out that the second largest partner (behind the US) is Switzerland. Exports of goods from the EU to Switzerland accounted for €170 billion in 2013. Also in services, Switzerland ranks as the EU's second largest services trade partner, with €83 billion. Trade drives growth and also is a risk diversifier, said Mr Adler: "The more trading partners you have, the lower the risk." He also remarked that Switzerland is the second largest investor in the EU after the United States, with foreign direct investment worth €505 billion; significantly larger than the next country on the list, which is Japan at €161 billion. Associated with investment comes employment, and around 1.1 million jobs have been directly created in the EU by Swiss companies. Within this context, Mr Adler moved on to say that the Capital Markets Union is extremely important and that Europe's partners can continue to contribute significantly to the economic activity and welfare of Europe, both directly and indirectly.

Ms Hardt presented some recommendations to help ensure that the EU is internationally competitive and an attractive place to invest, and to help maximise the benefits of closer political ties and policy-making with key partner countries. These include promoting open and transparent capital markets, and ensuring effective implementation and enforcement. The SFC points out that the CMU should encompass more than just the 28 Member States: "it's not a single, isolated pool of liquidity." Also important is consideration of international standards, such as the OECD standard on automatic exchange of information on tax matters. Ms Hardt also singled out IOSCO which has made a lot of progress regarding international standards in the markets. Regarding the Banking Union, a further recommendation would be to make sure that the differences between Eurozone and non-Eurozone banks don't fragment the internal market. On the contrary, a cooperative approach is needed. Turning to the CMU, Ms Hardt believes it has the potential to be a game-changer in terms of facilitating the flow of investment from both EU and non-EU countries into growth and job creating opportunities. Finally, she called for more cooperation between the EU and its key partners such as Switzerland, and highlighted the need to make equivalence internationally effective by enabling partner countries to collaborate in the working out of agreed guidelines.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Panel 1: A Global Perspective On Europe's Economy

The first panel included the following panellists:

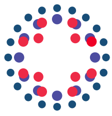
- **Axel Weber**, Chairman of the Board, UBS AG
- **Daniel Gros**, Director, Centre for European Policy Studies
- **André Sapir**, Professor of Economics, Université Libre de Bruxelles (ULB), Vice-Chair of the European Systemic Risk Board (ESRB), Senior Fellow, Bruegel
- **Rupert Schlegelmilch**, Director, DG Trade, European Commission
- **Beatrice Weder di Mauro**, Professor of Economics, University of Mainz
- **Fabrizio Saccomani**, Former Minister of Economy and Finance of Italy, Visiting Professor, LSE
- **Moderator: Rebecca Christie**, Bloomberg News

Axel Weber, Chairman of the Board, UBS AG

Rupert Schlegelmilch, Director, DG Trade, European Commission

Mr Weber pointed out that Switzerland is the second largest trading partner of the EU and highlighted the importance of financial inter-linkages in light of Switzerland's globally important financial services industry, including the two SFC member banks, with two dominant financial centres in Zurich and Geneva. He explained that the Swiss financial centre has recovered well since the start of the subprime crisis particularly in aspects such as capital and liquidity ratios as well as the strategic transformation of banking. This does not yet apply to the same degree to many EU-based financial institutions, however, where banks are still in the process of deleveraging, only a modest recovery in the banking industry's outlook and even less recovery in terms of general economic activity and employment. Against this background, strengthening the partnership with "third countries", such as Switzerland, could contribute significantly to a sustainable and faster conclusion of the recovery process within the EU. According to Mr Weber's, what is true to the banking sector, also applies to the capital markets union which he believes can only be successfully achieved when opening up national capital markets to international players with a strong link into the EU. He therefore encouraged EU decision-makers to access global capital market expertise by encouraging a dialogue with and access by strong players in Switzerland, the US, or Asia, for example, to realize the full potential of EU capital markets.

"In 2006, only a quarter of the EU's trade was covered by free trade agreements," said Mr Schlegelmilch. "Now, this figure is up to two-thirds." He pointed out the success of recent trade agreements made with Korea, Canada, South Africa and countries in West and East Africa, while admitting that the ongoing TTIP negotiations with the US are extremely important, as well as discussions proceeding with Japan, Vietnam, Malaysia and other countries. He also said that the EU is negotiating a new investment agreement with China. An important goal is to level the playing field for financial services, which means getting rid of market access barriers, caps, licensing procedures etc., as well as enabling free flow of data, and removing discrimination in taxation. The regulatory environment is also key; especially if anchored in a trade agreement which is accountable and transparent. "This is what we are trying to achieve," said Mr Schlegelmilch. "It's a difficult issue with lots of sensitivities involved, but we think the industry needs consistency and close supervisory coordination, which can lead to equivalence. We are doing this with the US and Japan, and this is where the future of the financial services trade agenda lies."

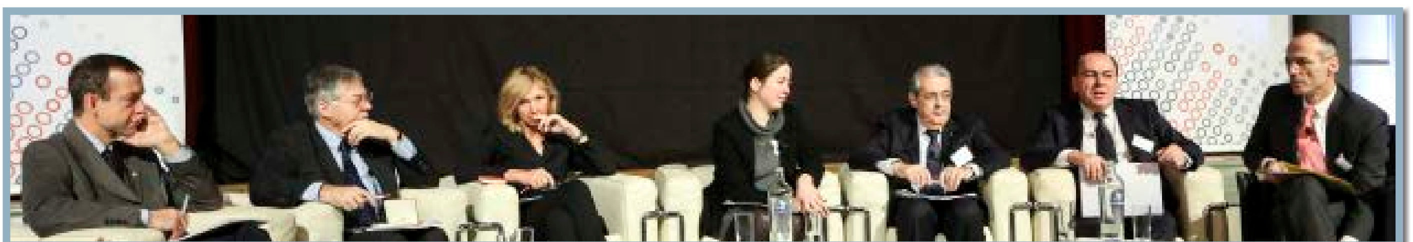


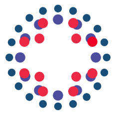
Fabrizio Saccomanni, Former Minister of Economy and Finance of Italy, Visiting Professor, LSE

Beatrice Weder di Mauro, Professor of Economics at the University of Mainz

Mr Saccomanni explained that he thinks the G20 process needs to become more effective. He thinks the G20 did good work at the beginning of the crisis but considers that its effects have diminished over the years. "If we really want to deal with the problems surrounding global financial retreat then this is where we need to act," he remarked. One concrete step forward would be fighting against tax evasion and profit shifting. This he believes would be a step forward to promoting greater financial stability and fiscal sustainability. He is disappointed at the lack of a fiscal policy stance in the European Union. He also believes that the European Union should come out with a strong strategic view on how to promote investment in the key sectors of energy, transportation, the digital agenda etc., by inviting the national monopolies to discuss these issues around the table. On the question of reforms, he believes there is a need to provide incentives to induce countries to make progress in the reform agenda.

"The long shadow of the financial crisis is still very much with us," remarked Professor Weder di Mauro, pointing out that the financial construct of the European Union still displays a degree of vulnerability, as recent events in Greece have clearly shown, although she does consider that these events could be a catalyst for further steps towards overcoming the crisis. She posed the question: "What has to be done to leave this shadow behind?" In her view, based on work she is carrying out with the Centre for Economic Policy Research (CEPR), it is necessary to deal with the public and private debt overhang. She suggests a coordinated debt reduction program for all the Eurozone countries which would include a combination of options to allow buy-back of debt in various ways. It could also include some GDP-indexed or threshold-indexed bond exchanges. The second part of such a package would be a vastly improved fiscal rule, including much stronger incentives to avoid going into over-borrowing again. The proposal would be to use the IMF framework which aims to tighten the criteria around when and at what instance restructuring becomes not only an option but a necessity.



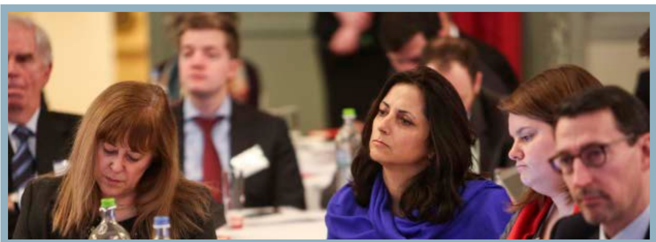


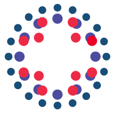
André Sapir, Professor of Economics at Université Libre de Bruxelles (ULB), Vice-Chair of the European Systemic Risk Board (ESRB), Senior Fellow, Bruegel

Daniel Gros, Director, CEPS - Centre for European Policy Studies

Professor Sapir began his presentation by praising the European Central Bank for launching its programme of Quantitative Easing (QE), although he did say that he wished it had happened a year ago. He thinks the QE program is important for the credibility of the ECB; to help it achieve its own medium-term inflation objective of close to or below 2%. But he thinks it is relevant to the debt overhang too, and expects it to be a boost to the Eurozone economy. Professor Sapir also referred to the G20, and its rather "benign" view on QE. As to the Greek problem, he believes a systemic solution needs to be found. He then turned to what he expects to happen during 2015/16, which is growth in exports, but asked whether this growth will lead to investment? "This is a key question," he said, "because falling investment has hurt the European economy, and it's hard to get investment re-started." In this respect, he believes that a single market in terms of financial services is a very important dimension for the investment climate. His final comment was that policy makers had failed to take advantage of the financial crisis to transform the economy, so far the focus had been more on repairing it.

The fall in cross-border capital flows was addressed by Mr Gros, who categorised capital flows as either good or potentially bad; the latter being short-term debt flows and bank credit. He pointed out a recent ECB publication in which capital flows are measured, which shows that equity flows have been rather stable, but the bank/debt flows have diminished, which Mr Gros believes is a positive situation as it makes the system more stable. His second theme was the Capital Markets Union. He asked whether it will be able to achieve a lot in terms of cross-border capital flows. His doubt stems from the observation that to develop more capital market instruments, one needs to invest in it. Unfortunately, if the savings-rich countries in Europe are considered, then he thinks that the savers demand debt instruments. "Unless you change this situation, I can't see how you can increase equity financing," he said. His recommendation to policy-makers would be to increase the attractiveness of either very long-term debt or more ideally an equity instrument at the national level, as opposed to bank assets for savers.





Closing comments

In his final remarks Mr Weber followed up on the other panellists' prior contributions. He agreed with Mr Gros that a new culture is needed in the EU in order to boost capital market development. EU investors are only starting to realize the opportunities of equity and equity-related instruments, and Mr. Weber highlighted that changing this culture will also require a reform of pension systems by moving from a pay-as-you-go approach towards fully funded systems. In this respect, he expressed his conviction that Europe can learn from experiences in the US and in Switzerland, and global banks can play a key role in facilitating this development.

Mr Weber also agreed with Mr Schlegelmilch that it is important for the EU to move forward on bilateral agreements not only within the ambit of trade, but also on the services side and with as many partners as possible - including Switzerland. He expressed his personal support in particular to a financial services agreement between the EU and Switzerland, which in his view is needed quickly. Open markets also need to be promoted more actively in order to change the public perception of 'bad' cross-border financial flows. In addition, achieving more international convergence in regulatory matters, as Mr Saccomanni requested, would also help to contribute towards open capital markets. Mr Weber finally pointed out that the regulatory environment for long-term investments needs a final tweak within the EU to make long-term investments more attractive for players like insurance companies and pension funds as well as for private investors.

Panel 2: Financial regulation – Fostering growth in Europe

The second panel took for the form of a Q&A session between the following panellists:

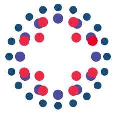
- **Karel Lannoo**, Chief Executive, CEPS
- **Howard Davies**, Professor at Sciences Po in Paris
- **Jacques de Larosière**, Chairman, EUROFI
- **Urs Rohner**, Chairman of the Board, Credit Suisse Group AG
- **Arlene McCarthy**, Special Advisor to the Chairman of Bloomberg and Associate Deputy Chair for Europe, Sovereign Strategy
- **Moderator: Jeremy Grant**, Financial Times

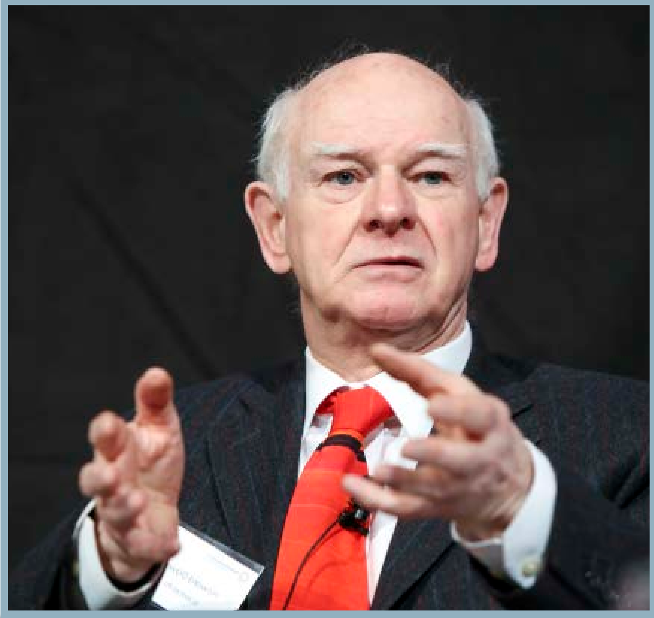
Urs Rohner, Chairman of the Board, Credit Suisse Group AG

Jacques de Larosière, Chairman, EUROFI

The discussion was initiated around the challenge of regulatory complexity and the ways to facilitate economic growth despite increasing regulatory demands on banks. In his response, Mr Rohner noted that regulatory complexi¬ty is particularly challenging for internationally active banks. Regulation has forced the industry to reconsider the attractiveness of the respective markets and has led to a market exit of several institutions in various previously interesting regions. And although sensible regulation makes clear sense in terms of preventing another financial crisis, overly complex rules result in quite the opposite: they generate risks, notably in operational terms. Moreover, there is a trend towards regulatory protectionism and policy fragmentation, which significantly contributes towards other challenges faced by financial institutions, thereby impacting credit extension and growth. Mr. Rohner stressed the need for greater coordination among legislators, citing the example of regulatory equivalence between the EU and Switzerland.

Mr de Larosière said that regulatory compliance is not new, but agreed that it is increasingly complex. He said that regulation should be very simple, principle-based, and that its execution should be verified by supervisors in a coordinated way. He gave an example of a recent study that showed that small community banks in the US have been more affected by regulatory complexity than by the financial crisis, and many are closing down due to unprofitability driven by regulatory complexity.



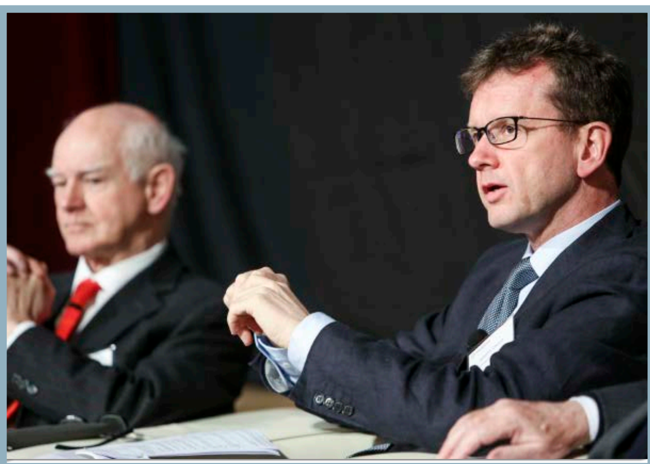


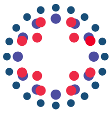
Howard Davies, Professor at Sciences Po in Paris

Arlene McCarthy, Special Advisor to the Chairman of Bloomberg and Associate Deputy Chair for Europe, Sovereign Strategy

Mr Davies would like to see a global exercise, probably led by the Financial Stability Board, to look at the whole of banking regulation. In the meantime, the elements that concern him the most are those that point in opposite directions and generate conflict. He gave the example of the approach to risk-rated assets, which in principle is correct but which conflicts with a leverage ratio approach. He also struggles to see who is looking at the overall impact of regulation, and whether the system is being over-specified in the light of the kind of financial markets desired.

Ms McCarthy pointed out that now we are entering the implementation phase and shifting towards a growth agenda, a number of priorities need to be addressed. One of these would be to open up cross-border compliance regimes and return to a scenario of consumer protection. The objective, she said, would be to have a workable system that does not impede growth.

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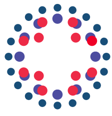
Karel Lannoo, Chief Executive, CEPS

According to Mr Lannoo, Asia has a very complex environment but jurisdictions are cooperating with each other without the intermediary of strong international institutions in a way that is surprising to Europeans. "In Europe, on the other hand, we need a very complex system to make us cooperate," he said. He also remarked that the number of banks in Europe active on a cross-border basis is a small minority – maybe 20 or 30 out of 1100. This means that rules are being made that are only applicable to a few.

Against this background, Mr. Rohner views the CMU as a clearly positive development. Two priority areas in this regard include a facilitation of SME lending and of the securitisation market. A functional framework would give investors the necessary confidence. At the same time, a credible rating system for securities products may also be required and some of the current capital rules may need to be revisited.

Mr de Larosière does not believe that SMEs will be much better off under the CMU. He described the two categories of SME in Europe: those that are profitable and which have no real problem in getting finance; and those that are not profitable and which have big



problems accessing markets and banks. In his view, improving the capital markets may marginally facilitate the life of the SMEs that are OK, but will not fundamentally solve the problem of those that are not OK, due to the underlying structural problems. He would have added a structural element to the CMU, as well as a fiscal union.

"I think that the Commission does not do enough comparative work looking at what works in different EU countries and trying to spread best practice," Mr Davies said. "I think that more can be done by spreading best practice than by saying 'let's have a rule or a directive'." One example would be the greater use of venture capital companies through Europe. He also believes that the European Securities and Markets Authority (ESMA) could do more and be given greater power to initiate or lead projects in the Capital Markets Union.

Ms McCarthy pointed out that ESMA is very poorly resourced yet is being asked to do even more, such as looking at equivalence regimes for Singapore and Hong Kong. Member States don't want to give them more resources because they see a competition to their own supervision. Mr Lannoo said that the tragedy is that the budget of the supervisory authorities has already been cut for this year, and compared the 180 or so people working at ESMA with around 1500 people at the US's Consumer Bureau.

A question was raised by a delegate as to the supplementary elements that the European Banking Union needs to have? Mr Davies said that in the long run the Eurozone needs a well-funded, well-resourced body that recapitalises banks in trouble, and a pan-Eurozone deposit protection zone, although he is aware that these raise fiscal transfer difficulties.

Another question from the floor was whether there is a need in Europe to shift towards what the US has proposed: a single point of entry mechanism impacting the governance structure of European banking groups. Mr Rohner said he is a proponent of the single point of entry concept, but believes it will not easily be achieved in the Eurozone, mainly because the European banking sector is not structured via bank holding companies as in the US, and therefore the change from one to the other would be quite cumbersome.

Finally, Mr Grant asked panellists to briefly describe a solution to deal with regulatory complexity and growth:

- Mr Rohner: A more principle-based approach and strong supervision.
- Ms McCarthy: For the FSB to play a role as arbitrator or mediator, and for the Commission to create a third-country equivalence regime for financial services.
- Mr Davies: A full-scale impact assessment of what has been done and whether there are elements that could be recalibrated because they are over-complex and over-constraining.
- Mr de Larosière: Add the international aspect to the ways the rules are enacted Europe is too ivory tower focused.
- Mr Lannoo: Respect the principle of proportionality; look at best practices in Member States; and consider a common repository to compare enterprises' finance information.