Q&A

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Spotlight on EU financial policy developments: Capital Markets Union and Basel III

How important are capital markets for the post-Covid economic recovery, the green and digital transition and ensuring Europe's financial autonomy? How is the Commission approaching the next steps of the CMU initiative?

The Capital Markets Union is vital for the EU's economic agenda. Especially in the current circumstances, making progress on the CMU will help us deliver our economic policy goals.

Strong and well-integrated capital markets are essential to help firms access wider sources of financing. They can also help channel savings into productive investment. The CMU can mobilise huge investment to tackle climate and environmental challenges and to support the digitalisation of the EU economy. Crucially, the CMU and the Banking Union can together build a strong, competitive and integrated European financial system.

That in turn can strengthen the EU's global economic role and open strategic autonomy, including via a stronger international role of the euro.

We do need to recognise that the CMU is a long-term project and we need patience and perseverance. It is a structural reform project that addresses deep-seated differences across Member States. Building the CMU requires ambition and strong political commitment from Member States and the European Parliament.

By the end of this Commission's mandate in 2024, we hope the co-legislators will have adopted most of the measures proposed, including on the more structural proposals such as corporate insolvency law and withholding tax.

I want to help make sure that the financial sector can rightly be seen as a driver of growth and an accelerator of the transition to a green and digital economy by the end of my mandate.

How is the Commission approaching the next steps of the CMU initiative? Will the action plan[1] published in November 2021 allow a step change in terms of development and integration of EU capital markets?

Companies need access to more diverse sources of funding to grow and innovate. People need better returns on their money. And we need to break down the remaining barriers between European capital markets to build the CMU.

In September 2020, we presented a new CMU action plan to accelerate our work. On 25 November 2021, we took a major step forward on that plan by adopting a package of four legislative proposals. First, we are increasing market transparency by reviewing MiFIR and introducing a European consolidated tape for trading data. Second, we are creating a European Single Access Point, which will put information at investors' fingertips while giving companies more visibility to investors. Third, we are reviewing the rules for European Long-Term Investment Funds to make them more attractive. And fourth, we are making targeted changes to the Alternative Fund Managers Directive to help asset management work more efficiently.

More work is to come in 2022. A Listing Review will encourage more companies to list on EU public markets, particularly SMEs. We will make a targeted legislative proposal to harmonise some corporate insolvency rules. Making it easier to predict the outcome of insolvency proceedings across the EU is particularly important for cross-border investors. And we will also focus on financial education, so people can ask the right questions and know what products work for them. Last month we finalised a financial literacy framework together with the OECD which will help Member States, financial companies, businesses, civil society and educational institutions design effective financial education programmes. Finally, we will set up an open finance framework to allow data to be shared and re-used by financial institutions to create new products and services for consumers and companies – while keeping people in control of their own data.

How is the clearing landscape evolving in Europe one year after Brexit and what are the key issues remaining to be tackled in terms of financial stability and competitiveness?

In September 2020, the Commission adopted an equivalence decision for UK CCPs set to expire on 30 June 2022 to avoid the financial stability risks entailed by an abrupt disruption in the access of EU market participants to UK CCPs. In this equivalence decision, market participants were urged to reduce their exposures to UK CCPs. This over-reliance on UK-based CCPs raises concerns for our regulatory and supervisory autonomy and implies financial stability risks for the European Union, notably in the event of stress in these CCPs. The move of derivatives from London to the EU so far has been marginal and the over-reliance on those CCPs – and associated risks – persist. ESMA confirmed in its assessment that some of the services provided by UK CCPs are systemic but that forcing relocation at this juncture would be too costly for EU market participants. In addition, the Commission conducted work in 2021 with European public authorities on how to build strong and attractive central clearing capacity in the EU that showed we need to encourage infrastructure development and reform supervisory arrangements. But it was clear that June 2022 was too short a deadline. This is why I recently announced that we plan to extend the equivalence decision by another 3 years. Nevertheless, this extension does not address our medium-term financial stability concerns. We will soon launch a public consultation on the best way to achieve our goal. In the second half of the year, I intend to come forward with measures to make the EU an attractive clearing hub. I will propose ways to increase liquidity in EU CCPs and expand the range of clearing solutions on offer. If the EU is to increase its capacity for central clearing, it is essential that risks are well-managed and the EU's supervisory framework for CCPs is strengthened, including a bigger role for EU-level supervision.

To what extent can the Basel III package effectively improve the comparability of the risk-based capital ratios of banks in the EU and globally?

The banking package proposed by the Commission last October addresses the remaining shortcomings of the prudential framework identified in the aftermath of the financial crisis, including the lack of comparability of risk-based capital ratios. The proposed measures will constrain and frame the use of internal models to calculate capital requirements while increasing the risk sensitivity of standardised approaches. For operational risk and credit valuation adjustment risk, models will no longer be available. For credit risk and market risk, their use will remain possible for assets where there is reliable data, subject to input and output floors. To effectively improve the comparability of risk-based capital ratios and restore their credibility, all parts of the final Basel III reform need to be implemented. The Commission's legislative package would achieve just that.

Is the increased granularity of the proposed framework leading to improved proportionality and simplicity?

The banking package will increase the granularity of the framework in a targeted manner and only in the few areas required for robust risk measurement – for instance when it comes to the modelling of certain trading activities or the standardised treatment of equities or specific forms of mortgage lending. Most of the proposed measures, however, will simplify the rulebook by removing or better framing the more complex approaches that banks can currently use to calculate their capital requirements. So the package carefully balances comparability, risk sensitivity and simplicity. It will lead to more proportionate outcomes with less administrative burden.

Can international standards adapt to the specificities of different regions in terms of financing, notably those such as Europe where banks play an important role?

An open, global financial system requires global standards for safety and soundness. Without them, any single jurisdiction neglecting financial stability can result in spillover effects for other jurisdictions, as the global financial crisis vividly demonstrated. Global regulatory cooperation is therefore essential for global financial stability. But global cooperation does not mean full harmonisation of prudential regulations. Instead, the Basel framework is designed to serve as a minimum level playing field, a common baseline that reflects differences among jurisdictions. If domestic transposition processes of international standards show that certain specific features need to be accommodated, then there is room to do so without compromising the integrity of the overall framework. Our banking package respects the international agreement while taking into account the EU economy's specific characteristics. In the EU we support multilateral approaches to address important global issues, so we must faithfully implement solutions agreed at international level. Only then can we expect our international partners to do the same.

Is the Basel Framework well fitted for addressing sustainability risks?

To some extent, the Basel Framework already captures sustainability risks. Work by the ECB/European Systemic Risk Board (ESRB)[2] suggests that climate risks manifest through traditional risk types. Nevertheless, the Basel Committee identified relevant areas where climate risks may not be adequately captured by the existing framework. It is currently exploring options to close these gaps. As observers in the Basel process, we are closely following this work and providing our input. In the EU, we have already started to incorporate sustainability risks in the prudential framework for banks. In 2019, CRR II introduced disclosure requirements for ESG risks. The recently adopted Banking package went even further by proposing to hardwire ESG risks in banks' risk management processes, supervisors' SREP processes, and stress tests.

What is being envisaged to tackle the concerning points (e.g., physical risk underestimation, difficulties to approach the very long term, ...) unveiled by the stress tests?

Stress tests are a powerful tool to assess the non-linear and unique features of climate risks. They are useful for supervisors to assess whether banks are resilient enough to withstand financial and economic shocks, in the short, medium and long term. The banking package we adopted last October would empower supervisors to incorporate ESG risks in supervisory stress testing and in the supervisory review of banks' risk management practices, and require stress testing by institutions. The outcome of those exercises – and any points of concern they may reveal – may then influence the review and evaluation process (SREP) of each bank and allow supervisors to take action through Pillar 2 measures.

1. ['Action plan' should be corrected and read 'package']
2. ECB/ESRB Project Team on climate risk monitoring (2021), "Climate-related risk and financial stability", ECB/European Systemic Risk Board, July.