RESET FINANCE

Key Reforms to Reset the Financial System in 2024-2029

A list of civil society policy reforms to reinforce EU financial regulation

Help make a difference

Support #ResetFinance

A CAMPAIGN BY Finance Watch FINANZWENDE e.V.

Introduction & key messages

Reset Finance sets out a *common vision* to reform the financial system. This vision outlines the way to address the risks stemming from today's oversized, complex, increasingly digitalised, and interconnected financial system.

The financial reform agenda after the 2008 crisis has long since stalled and after years of technical discussions has become infiltrated by vested interests. Financial lobbyists called for and received the delays and exceptions in the rules resulting in weak regulation. This is a dangerous path that puts public interest - financial stability and the protection of consumers - at risk.

It is time to step back and push the reset button before the next major crisis happens. Our leaders must give the financial system a clear purpose, safety and resilience to support people and the planet.

European civil society organisations and experts call on policymakers to make the much needed reforms to the financial system for Europe's citizens and our future:

- **Stable Finance policy reforms** to end financial crises and taxpayers' bailouts
- **Extractive vs Sustainable Finance policy reforms** to rein in financialisation's predatory practices and enable the transition to a sustainable and just economy
- **Retail Finance/ Financial Inclusion policy reforms** to ensure safe financial practices and equal participation
- **Digital Finance policy reforms** to ensure financial stability, citizens' data, privacy, and financial interests are protected
- **Public Finance policy reforms** to integrate future generations' interest are taken into account and unlock investment in our future
- **Democracy policy reforms** to ensure the public interest is properly represented in supervision and regulation.

The following pages provide a breakdown of specific policy reforms to make this vision happen. The list of civil society organisations and experts calling for these reforms can be found on the campaign page. To endorse these demands in the run-up to the EU elections, visit our campaign page www.finance-watch.org/reset-finance.

To get to a financial system with a purpose that works for people and the planet, we need:

1. To reset regulation supposed to protect us from failing institutions and future financial crises

This means:

➔ **Financial institutions are adequately capitalised, i.e. to a level that allows them to operate and, if necessary, be placed into bankruptcy or resolution without recourse to public funds.**

- International frameworks on capital requirements should be fully implemented into the EU banking prudential regulation. EU institutions and member states should support the call for higher capital requirements in banking and advocate for them in the relevant international fora, notably the FSB and BCBS.
- Transitional provisions in EU insurance prudential rules should be quickly phased out and capital requirements should be calibrated to adequately reflect risks, which is a precondition to stimulate investment and adequately allocate capital.
- Review of the macroprudential framework for banks should be completed and usability and consistency of application of the macroprudential buffers should be improved, to ensure that they address structural or cyclical risks.
- New dedicated macroprudential tools should be introduced to address the systemic dimension of climate-related risks.
- Minimum leverage ratios in banking should be raised significantly.
- The Crisis Management and Deposit Insurance (CMDI) review should be completed to make the bank crisis mechanism operational, to establish the European Deposit Insurance Scheme (EDIS) and allow the ECB to provide liquidity in resolution.
- Liquidity requirements should be increased and requirements on banks' sovereign exposure risk should be adequately designed to sever the bank-sovereign nexus.
- Systemically important and significant banks should be resolvable and should be placed into resolution when needed. All other banks should be wound up strictly without recourse to extraordinary public financial support.
- All banking groups which are deemed "systemically important" or "significant" and may therefore potentially undergo resolution should be required to properly implement the burden-sharing clause. They should have capital and bail-inable liabilities amounting to at least 8% of their balance sheet total. Bail-inable liabilities should be statutorily subordinated to general unsecured creditors, without exception.

➔ **Financial institutions are resilient against environment-related financial stability risks.**

- Higher capital requirements for fossil fuel-related financing and investment exposures should be introduced. In particular, the one-for-one rule should require that every euro of financing that banks and insurers provide to fossil fuel expansion-related entities is backed by one euro of their own funds to guard against risks of stranded assets and future losses.
- Macroprudential authorities should impose either capital requirements or a cap on fossil fuel financing when the loan-to-value ratio of the fossil fuel financing provided by financial institutions is above 100% (the value being defined as the value of exploitable fossil fuels to limit global warming to 2°C).
- Supervisory authorities should ensure climate scenario analyses and stress tests are conducted using technically sound and realistic different types of models as well as adequate assumptions and time horizon in order to derive plausible and meaningful conclusions.

- Financial institutions should adopt comprehensive transition plans and targets based on double materiality. Supervisors should include these plans and targets in their supervisory review and be in a position to intervene, including but not limited to assigning capital add-ons for inadequately managed risks.

→ **Financial regulation of different types of entities (banks, insurers, investment funds, BigTech, FinTech and others) and activities (e.g. securitisation, leveraged loans) is commensurate with the level of risk that such entities pose to the users of financial services and the stability of the financial system.**

- Open-ended investment funds (such as money market funds or private debt funds) should be subject to restrictions on eligible assets, minimum liquidity buffer requirements to mitigate structural liquidity mismatches and stability risks.

- Leveraged funds such as private debt funds and hedge funds should be subject to adequate leverage restrictions.

- The Financial Conglomerates Directive should be reviewed to broaden the scope of supervised entities and activities, notably including activities of BigTech companies. Trends towards harmful supply-side concentration in digital financial service provision should be addressed through effective forward-looking competition policy.

→ **Systemically important financial conglomerates are restructured to ensure they can be resolved whilst keeping their critical functions intact, without recourse to public funds.**

- Investment banking should be structurally separated from commercial banking activities by reviving the legislative proposal for Banking Structural Reform of 2014.

→ **European Supervisory Authorities (ESAs) are independent, equipped with adequate tools, supervisory powers and resources to deliver on their mandates and foster supervisory convergence.**

- ESAs governing bodies should be reformed to eliminate the conflicts of interest embedded in the current structure.

- ESAs resources should be made commensurate with their mandates and needs to adequately execute their tasks.

- ESAs enforcement and powers and information rights should be strengthened.

- ESAs should receive direct supervisory powers in targeted areas such as the ones with substantial cross-border activities and systemic risk/contagion implications.

→ **Equity funding in the real economy is made more attractive, e.g. by removing the tax deductibility of debt interest for corporate borrowers.**

- The corporation tax deductibility of debt interest for corporate borrowers should be removed.

- Different corporation tax rates on retained vs. distributed net profits should be considered to encourage internal funding of corporate investment.

→ **Employee participation models are promoted to improve governance and fairer distribution of corporate profits among stakeholders (management, debt and equity investors, employees).**

2. To reset the role of finance, ending extractive practices and enabling a sustainable future

This means:

→ **With a view of making sustainable finance impactful, ESG or sustainability claims of financial institutions are verified by supervisors and recognised as legitimate only for institutions that sell one or more of the three following climate-related financial products:**

- Investment funds systematically engaging with investee companies on sustainability issues.

- Transition-linked financial products or instruments, including debt with climate covenants attached.

- Taxonomy-aligned investment products.

→ **Financial institutions and companies are governed in a way that considers environmental and social factors. Business models that are solely based on short-term gains and extracting profits need to be curtailed.**

- Variable remuneration of directors should be linked to the achievement of sustainability goals and avoid key performance indicators that motivate short-termist incentives to engage in economic activities with negative impacts on society and environment.

- Financial institutions should be required to conduct meaningful due diligence to adequately incorporate sustainability risks and impacts across their entire value chain and support human rights and environmental protection.

- Boards of directors should be required to have the necessary expertise and experience on sustainability matters to be able to act in the long-term interests of the company and of society.

- Rules should be introduced to stop private equity companies from extracting value through asset stripping (e.g. excessive dividend payments, capital reduction, share redemption, own share acquisition) for the entire period of ownership.

→ **Sustainable finance regulation enables and stimulates businesses and the financial sector to transition to a sustainable economy and finance economic activities that are in line with EU environmental and social objectives**

- Mandatory transition plans and sustainability targets based on scientific evidence for actors in the financial sector and real economy should be mainstreamed and aligned across EU legislation to ensure coherence.

- Clear standards should be developed for investor engagement with the companies they invest in, and any barriers to collaborative shareholder engagement on sustainability should be removed.

- The environmental taxonomy should be used to integrate credible "transition" activities with clear intermediate targets to mitigate negative sustainability impacts. Transition finance should also be clearly defined in EU law.

- A ''harmful'' taxonomy should be developed to define which business activities harm the climate and the environment, and need to be phased out. Expansion of these activities should be stopped immediately.

- The interoperability of the EU taxonomy with classification systems from other jurisdictions should be achieved by pursuing the work started by the international platform on sustainable finance and issuing adequate tools to allow appropriate comparison and estimates.

→ **The ECB adopts green credit guidance that will enable and stimulate the financial sector and markets to transition to a sustainable economy**

- The ECB should adjust its haircut system to limit and/or outright exclude polluting assets from its collateral framework and lending operations.

- The ECB should adopt green dual rates or, in other words, lower interest rates on its lending operations to banks that issue loans for green investments.

→ **Environmental and social impacts and risks of economic activities and financial products are robustly defined, made transparent (disclosed), gradually mitigated, and monitored by supervisors.**

- The Sustainable Finance Disclosure regulation (SFDR) should introduce a classification setting minimum criteria and providing the distinction between products committing to invest in sustainable activities and products committing to support the transition of companies towards sustainable activities.

- Sustainability reporting standards should ensure that all companies, across sectors and of all sizes, consistently report high-quality and transparent information on the environmental and social impacts of economic activities and financial products.

- The European Sustainability Reporting Standards (ESRS) 'Set 2' should define sector-specific indicators building on the EFRAG technical recommendations.

- Minimum mandatory criteria should be developed to define sustainable investment products. This should include removing ambiguity in assessing the adverse impact consideration by a financial product.

→ **A classification system for considering the social dimension in the Taxonomy is developed to support a just transition.**

- The current Taxonomy should be reinforced by further detailing the social dimension. This will promote the development of socially responsible business models and the integration of this concept in investment and financing strategies.

- Housing and health should be considered as special asset classes within the Social Taxonomy. This should include definitions of adequate living standards or standards of care, as well as looking at the processes and practices of companies that manage housing or health assets.

→ **Consumers are able to distinguish sustainable financial products from conventional ones and comprehend their features through clear terminology.**

- The definitions of retail investors' sustainability preferences included in the Markets in Financial Instruments Directive (MiFID) and Insurance Distribution Directive (IDD) Delegated Acts should be aligned with the definitions of sustainable products in the revised SFDR and the PRIIPS key information document to ensure consistency and clarity.
- Methodologies to define Climate Transition Benchmarks and EU Paris-Aligned Benchmarks should be improved and ensure an absolute decarbonisation of investments. Their application should be regulated to prevent the development of sustainable products that do not result in a physical holding of the underlying securities.
- Minimum criteria and transparency requirements should be introduced for all sustainability/green bonds to help assess the contribution of those products to the transition targets achievements.

→ **Tax havens are dried up in order to prohibit tax avoidance by financial actors.**

- Aggressive tax planning by funds using pure holding companies for private equity, real estate and infrastructure investments and shifting profits to low-tax jurisdictions should be prevented, amongst other things.

→ **A financial transaction tax is introduced to prevent undesirable developments in the financial markets and make those who cause financial crises bear the costs.**

- A financial transaction tax should be introduced for all types of financial transactions. This aims to restrict activities like high-frequency trading on financial markets and make the financial sector more resilient to future financial crises.

→ **Investment fund managers do not impose a level of leverage that is detrimental to investee companies and their employees.**

- Private equity firms and managers should be legally responsible for the debt imposed on portfolio firms.
- Leveraged lenders should retain risk on their balance sheets to reduce the excessive risk-taking and attractiveness of leveraged buyouts.
- For portfolio firm bankruptcies, wages, severance and violation payments should be protected in the bankruptcy process.

3. To reset financial practices that exclude or harm consumers, ensure their full and equal participation and protection in the retail financial services market

This means:

→ **All citizens have access to and the market makes available affordable basic financial services that are needed to fully and equally participate in society, including cash.**

- The Payment Accounts Directive (PAD) should be amended to ensure that vulnerable consumers in the EU have access to affordable basic payment accounts.
- ATMs in the EU should be mapped and regularly updated, to ensure that EU citizens have guaranteed access to cash.
- Acceptance of cash should be made mandatory for all businesses that do not exclusively operate online.
- The Pan-European Personal Pension Product (PEPP) regulation should be revised to ensure safe basic personal pension products are widely available and can be accessed by all consumers with low fees.
- Funded pension products, in particular close to the payout phase, should be adequately shielded from financial fluctuations to ensure adequate incomes for the people who have to rely on them for a significant part of their lives.

→ **Unfair barriers to access financial services such as discrimination based on someone's financial situation, digital savviness, ethnicity or age, are removed.**

- Automated decision-making tools assisted by AI (including algorithms) which are used by financial institutions should be properly regulated and supervised to avoid discrimination or exclusion.
- Financial supervisors should conduct mystery shopping exercises to audit the extent of discrimination or discriminatory practices in the provision of financial products.

- The proposed horizontal equal treatment directive should be finalised and include financial services within its scope.
- Use of irrelevant data should be prohibited in the pre-contractual sales process for financial services.

➔ **Financial product information provided to consumers such as disclosures and marketing materials is simple, understandable, non-misleading and covers key risks and costs of a product.**

- Consumers should receive complete, clear, accurate, and bias-free information on the costs, the risks, financial and sustainability characteristics of investment and insurance products, including hidden or on-off costs and taxes. Standard sustainability criteria proposed to clients should meet minimum thresholds to prevent misleading sustainability statements.
- Mandatory information disclosures across EU financial regulation should be available in formats accessible to persons with a disability and through a durable medium where requested at no extra cost.
- Social media influencers promoting financial services ('finfluencers') should be adequately regulated under the Unfair Commercial Practices Directive (UCPD).

➔ **Consumers have access to unbiased and high quality financial advice**

- The rules regulating the retail investment market (MiFID II and IDD) should be changed to remove conflicts of interest in selling these products, including to ban inducements paid to advisors.
- Professional training requirements for financial advisors should be improved, including to ensure sufficient sustainability knowledge and expertise.

➔ **Financial service providers and sales practices are adequately regulated to prevent mis-selling of financial products and/or taking advantage of behavioural biases of consumers. Consumers have access to effective and easily accessible remedies in case of product mis-selling, misconduct and abuse by firms.**

➔ **Effective and accessible debt relief mechanisms are in place to help consumers facing over-indebtedness.**

- An EU harmonised personal insolvency scheme incorporating best practices should be introduced to ensure that all EU citizens who need it have access to personal insolvency schemes that are fair, effective and provide a true fresh start.
- Forbearance measures in the Mortgage Credit Directive (MCD) should be strengthened to help consumers who are struggling to repay their mortgages before having to face enforcement proceedings.

4. To reset rules in the digital world, protecting data and privacy, financial stability and consumer interests

This means:

➔ **Prudential and conduct frameworks for financial firms and crypto-asset service providers are robust and take into account the particular risk profile of crypto-assets.**

- Services related to crypto-assets that are equivalent to those offered for 'traditional' financial instruments in form, substance and practical use should be brought under existing securities regulations (e.g. MiFIR/MiFID).
- Services that are known to cause risk to conflicts of interest, e.g. operating an exchange and, simultaneously, making markets in assets traded on that exchange, should be separated for crypto-assets as they are already for 'traditional' financial instruments.

➔ **Consumer data and privacy is adequately protected.**

- New regulation establishing an open finance framework (the Financial Data Access Regulation) should lay down legally-binding rules (regulatory technical standards) on what types of data can be used for different use cases in the provision of financial services to prevent misuse of consumer data by financial services providers.

➔ **New and innovative financial services are properly regulated before entering the market.**

- Peer-to-peer lending should be regulated, either within the scope of the Business Crowdfunding Regulation or through standalone legislation.

→ **Digital tools, including tools assisted by artificial intelligence (AI), used by financial services providers (e.g. robo-advisors, automated decision-making tools) are adequately regulated and information is transparent for the user.**

- Every upcoming review of consumer protection legislation in the EU financial services sector should include adequate rules on the usage of digital tools, in particular tools assisted by AI.
- AI-assisted systems used by financial institutions are regularly supervised and reviewed by national competent authorities.

→ **All tokens which serve primarily as financial instruments ('securities tokens') are brought under existing securities markets regulation in order to protect investors´ interests.**

- Crypto-assets that resemble financial instruments in form, substance and practical use should be regulated as such, i.e. as 'securities tokens' under existing securities regulations (MiFIR/MiFID)
- Effective and accessible means for reporting, remedy, redress and access to justice should be created and promoted among all users of digital finance.

5. To reset rules on public finance and unlock investment in our future

This means:

→ **EU fiscal rules rely on a robust and granular analysis of debt sustainability - not on arbitrary indicators and unobservable measures.**

- The stability and growth pact should be reformed to scrap numerical debt reduction benchmarks and complete the move to more advanced debt sustainability analysis. The references to arbitrary limits of 3% deficit and 60% debt-to-GDP should be removed in Protocol 12 to the EU Treaties.

→ **The ECB incentivises green public investment**

- A permanent green public bond purchasing facility should be set up to incentivise green public investment by lowering their financing costs. The facility should be available to governments, regional governments and municipalities, supranational bodies like the EIB and national development banks, and the European Commission.
- Preferential treatment for green public bonds should be implemented within the collateral framework, which would include applying reduced haircuts on green public bonds to stimulate the demand for these bonds

→ **Member States have incentives and are able to make sufficient qualitative investments and reforms to make the European economy stronger, more sustainable, democratic and inclusive.**

- A new EU investment fund should be established to support the green transition and important projects of common European interest.
- Qualitative and future-oriented investments aligned with EU priorities should be excluded from deficit and expenditure limits as part of Member States' fiscal structural plans.

→ **Improved EU's fiscal and economic coordination contributes towards and never contradicts the EU's own economic, environmental and social objectives.**

→ **Ensure minimum standards for the quality of public finance that support the realisation of EU objectives, such as the European Pillar of Social Rights and the European Green Deal.**

- Public budgets should include green budgeting, gender budgeting and an impact assessment on social cohesion.
- Independent audits of public spending, independence and effectiveness of courts and justice systems and the rule of law should ensure the efficiency and transparency of public spending and the elimination of corruption and mishandling of public funds. The EU should continue to establish rule of law reports and use the instruments at hand to achieve these aims.

→ **Ensure that the democratic principle is adequately implemented in EU economic governance with due involvement of social partners, the European Parliament and national parliaments.**

6. To reset the role of lobbying in lawmaking to rebalance the representation of the public interest in supervision and regulation.

This means:

- **Corporate lobbying, which weighs EU policy discussions towards short-term industry interests and away from wider environmental and societal considerations, should be better regulated.**

- **A balanced representation of civil society in the EU consultative and stakeholder groups and their governance should be ensured.**

RESET FINANCE

Help make a difference

Support

#ResetFinance

For any question about the campaign or the demands, please contact Paul Fox, *paul.fox@finance-watch.org*

To endorse these demands, please visit the page *finance-watch.org/reset-finance*

A CAMPAIGN BY

Finance Watch

FINANZ WENDE e.V.

 Finance Watch has received funding from the European Union to implement its work programme. There is no implied endorsement by the EU or the European Commission of Finance Watch's work, which remains the sole responsibility of Finance Watch.

Co-funded by the European Union