AFME-ICMA Capital Markets and Growth Roundtable and Dinner Discussion

30 September 2014, European Parliament, Brussels

Roundtable Summary

The notes below provide a summary of the AFME-ICMA Roundtable: Capital Markets and Growth organised in the European Parliament in Brussels on 30 September 2014. The event was held under the Chatham House Rule. Participants were from both the official sector and the private sector. Speakers expressed views in a personal capacity.

Executive summary

There should be no trade-off between financial stability and economic growth, but rather a shift in the focus of the defining themes for the new mandate from the former to the latter.

Capital Markets Union should facilitate more non-bank intermediation, but banks will be needed to contribute in their various functions. A holistic approach is needed. Different areas of the project may demand more regulation, sometimes less regulation or the adaptation of existing regulation.

EU markets remain fragmented and this is leading to underperformance. Europe can be globally competitive. But global success cannot be achieved without strong, integrated EU financial markets.

1st Theme: Where have we got to? Assessing the situation six years on

Introductory remarks

Participants noted that the new Commission will inherit a number of dossiers from the previous mandate. Specifically, the following primary legislation proposals will need to be finalised:

- Regulation on Bank Structural Measures – there is a high level of interest in this dossier among MEPs, with all Parliament political groups having expressed interest in the rapporteurship;
- Regulation on Money Market Funds;
- Regulation on Benchmarks.

In relation to Level 2 legislation, a key focus will be ensuring that the detailed rules to be formulated by the European Supervisory Authorities (ESAs) conform to what was intended by the legislators. MiFID/R and Solvency II in particular will involve a large number of complex delegated acts to be reviewed by the Parliament.

Further, a broader focus is needed – the new Commission should actively be looking for ways to promote economic growth and employment. Priority workstreams include:

- fostering an environment conducive to economic growth, long-term financing and investment;
- assessing whether the legislation enacted is achieving its objectives;
- assessing whether there are residual risks in the EU financial system that need addressing.

A major challenge facing the EU is the fall in private investment. There are large pools of savings awaiting appropriate investment opportunities. Stakeholders should remember that the primary purpose of financial markets is to provide liquidity and facilitate investment.

Current macroeconomic environment

Participants referred to the challenges for Europe to remain competitive in relation to other economies, notably the US and China, which have experienced a faster pace of economic growth.

One participant noted that the prevention of a collapse of the financial system and the euro had been an important achievement. However, there remains considerable macroeconomic uncertainty and the possibility of a prolonged period of stagnation in Europe. The European financial system remains fragile. Important changes to the EMU architecture still need to be completed.

Another participant felt that Europe had not elaborated a comprehensive strategy to tackle the crisis. The situation where there are "leaders and laggards" in Europe, with countries protecting their national interests, is leading to a lack of coherent policymaking. SMEs and peripheral EU Member States are experiencing particularly acute problems in accessing finance; it is important that new funding models through the capital markets are developed. It was also felt that there is a disconnect between stock market dynamics and the current state of the real economy.

Financial sector regulatory reform

One participant argued that further changes are needed to the structure of the euro and the EU financial system. The US, it was mentioned, had achieved more financial sector deleveraging than Europe. A decision had been made not to increase capital requirements in Europe to much higher levels – this had been a "pyrrhic victory" as higher capital requirements were in fact needed, according to this view. It was argued that major structural issues remain unresolved and that bail-inable debt provisions are not enough to address the too-big-to-fail problem. Taxpayers still feel that too-big-to-fail has not been solved and feel threatened by banks. According to this view, a systemic crisis would still appear to be unmanageable. As a result, this led to a temptation to micro-manage banks' policies.

Another participant argued that much has been done to address the vulnerabilities exposed by the financial crisis, including new frameworks for bank capital, liquidity and resolution, as well as Banking Union and capital markets reforms under MiFID/R and EMIR.

It was argued that effective capital markets require sound regulation and the right incentives for investment tailored to different needs and risk appetites. Has the right balance been achieved between enhancing safety and providing the necessary incentives for investment and risk-taking? In this context:

- Can banks make a reasonable return on risk capital to do what they are supposed to do?
- Is there a concern that bank management become ultra-cautious and risk averse?
- For capital markets to work effectively, have the authorities appropriately educated the public about the fact that this involves risks to participants?

The objectives of financial stability vs economic growth are not necessarily in conflict, one participant argued: but there is trade-off between them. The lack of growth is not due to regulation. In future, the financial stability agenda should not be left behind when focusing on making capital markets fit for growth.

2nd Theme: Exploring Capital Markets Union: Are Europe's capital markets fit for purpose?

Several participants offered perspectives on the shaping of a Capital Markets Union. It was generally felt that Europe needs to bolster non-bank intermediated funding as a matter of priority. Europe remains much more dependent on bank financing compared to the US where capital markets channels are more developed. However, the role of banks in providing certain services will remain important.

One participant observed that the future financial system should be underpinned by five values: it should be competitive, safe, stable, efficient and effective. Capital Markets Union should be guided by three principles.

- It has to contribute to growth and stability in the real economy. Alternatives to bank loans need to be nurtured; the question of yield will be important in providing the appropriate incentives in the private sector.

- It has to be designed to open new sources of finance for SMEs – this sector faces greater challenges in securing appropriate funding.

- The regulatory framework needs to be considered in a holistic manner in order to address unresolved issues. The term shadow banking is perhaps not ideal to refer to a number of non-bank mechanisms such as money market funds. But there is nevertheless a need to improve oversight and transparency in this sector.

It was also noted that the building of European capital markets had been the primary purpose of EU financial sector legislation prior to the financial crisis (e.g. through the implementation of the Financial Services Action Plan). Financial stability issues will remain important, but it is now time to resume the single market agenda that had been interrupted by the crisis.

Capital Markets Union should be a multidimensional project as part of a broad strategy. Appropriate frameworks need to be put in place to provide legal certainty and the right incentives. Technological issues also need to be examined. All asset classes should be considered as part of the project. While there had been progress in integrating equity markets, corporate debt markets in Europe remain fragmented and not sufficiently deep. Secured lending should also be a key area of work to address the challenge of channelling collateral more efficiently.

Another participant argued that new legislation is not always the answer to the needs of the economy. Markets are about choice, competition, expertise, sound corporate governance, low costs and liquidity provision. Successful markets cannot be created solely through legislation and new regulatory frameworks.

A number of potential areas of work were mentioned during the debate.

- The private placement market could be an important new source of finance to develop in Europe.
- Project and infrastructure finance is another area where better standards and enhancements to current market practices should be explored.
- Further work is needed on Europe's market infrastructures and addressing the Giovannini barriers, although progress is being achieved through the T2S and CSDR frameworks.
- Attention should be given to ensuring a well-functioning repo market as this is essential for the operation of fixed income markets.
- Other mechanisms to be explored include money market funds, crowd funding and social impact bonds.

The importance of liquidity provision in secondary markets was also mentioned. It was noted that market making capacity – in fixed income markets in particular – is being heavily constrained by the bank prudential regulatory framework. Policymakers should be mindful of the importance of market making to the long-term financing agenda and carefully consider the impact of existing requirements and proposals.

3rd Theme: Priority Legislative Actions 2015-2020

By way of introduction to this session, five potential areas of focus for the next mandate were noted.

- Ensuring appropriate implementation of legislation adopted in previous five years;
- Successfully implementing the Banking Union framework and making it work well;
- Continuing work on long-term financing initiatives, including high quality securitisation, private placements and SME data sharing mechanisms;
- Completing pending Level 1 legislative proposals;
- Capital Markets Union.

One participant commented that the main components of the response to the crisis have been put in place and cautioned against a new wave of legislation. It was argued that the private sector has to be more active in proposing solutions to promote better functioning markets.

Participants referred to a number of themes noted below.

High quality securitisation

The need to revive high quality securitisation markets in Europe was mentioned by various participants. The importance of achieving appropriate provisions in the Level 2 delegated acts for CRD IV and Solvency II was highlighted. One participant cautioned against the possibility of governments having to provide significant guarantees on securitisations.

International dimension

One participant emphasised that European financial markets need to remain open to investors and participants from other jurisdictions. Access to global markets and non-EU participants is essential as Europe does not have deep liquidity pools in every sector. It is important to achieve appropriate regimes for third countries in EU legislation.

Another participant suggested that ESMA should play a greater role in dialogue with third countries; CCP mutual recognition issues were referenced as a future challenging area. Consideration should also be given to the establishment of a Unit specialised in regulatory dialogue with third countries in the future DG for Financial Services, Financial Stability and Capital Markets Union.

Shadow banking and market infrastructures

One participant referred to the recovery and resolution of CCPs as a key future priority, with a Commission proposal expected in 2015. It was felt that the concentration of risk in clearing houses requires immediate attention.

In the shadow banking area, it was noted that the re-use of collateral is a significant and technically challenging area of concern. The current proposed Regulation on securities financing transactions was seen as important to enhance levels of transparency. One participant also argued that constant net asset value money market funds should be required to convert to variable net asset value models as per the current debate in this area.

Role of banks

It was noted that banks need to continue to play an important role in the financial system given that they are best placed to provide a range of functions. Some participants expressed concern about the potential impact of current bank structural reform proposals on the real economy, particularly as regards liquidity in corporate bond markets.

Role of CRAs

One participant mentioned that a punitive policy environment remains in relation to CRAs. This is evidenced by the proposed introduction of bans on the provision of credit ratings, as per the Regulation on money market funds. CRAs' role in providing credit assessment is needed and cannot easily be replaced.

4th Theme: Next Steps in developing a capital markets union?

Participants provided a range of perspectives on defining a Capital Markets Union, priority areas of focus and steps to be taken. This project was seen as a key deliverable for the next mandate.

Supervision

It was noted that parallels with Banking Union should be avoided as the context is different: while supervision and resolution were key pillars in Banking Union, they were unlikely to be an immediate priority for Capital Markets Union. In addition, Capital Markets Union was intended to cover the EU as a whole, whereas Banking Union was based on the euro area.

One participant cautioned against engaging in a time-consuming debate on new powers for the ESAs. There is a need for the ESAs to be good enforcers of EU laws, rather than direct supervisors themselves. Europe should focus on examining the concrete barriers preventing the development of capital markets and avoid an inward-looking debate on the institutional set-up.

A contrasting perspective was also offered, with another participant arguing that a strong and single European financial markets supervisor is needed in a Capital Markets Union. It was felt that an opportunity had been missed in the review of the ESAs to introduce enhanced binding mediation powers; the issue should be revisited.

Identification of Capital Markets Union workstreams

One participant commented that as an initial step it will be important to develop a good economic analysis of shortcomings in European funding models, market distortions and bottlenecks in consultation with stakeholders. It was stressed that the overall approach needs to be ambitious, well-targeted and go beyond existing workstreams.

Another participant commented that consideration should be given to the adoption of an omnibus Regulation to achieve consistency between legal instruments and unify the existing financial sector *acquis*.

Participants offered perspectives on the different workstreams and product areas to be considered. There was general agreement that securitisation, post-trade infrastructures, securities law, private placements and SME growth markets should be among the areas of future work. Choices will need to be made on the sectors to target; it was felt that a broad scope of asset classes (equities, fixed income, derivatives) and markets would be desirable.

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