LIGUE EUROPEENNE DE COOPERATION ECONOMIQUE

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EUROPEAN LEAGUE FOR ECONOMIC COOPERATION

MONETARY COMMISSION - COMMISSION MONÉTAIRE

The Capital Markets Union - a world without banks?

Amsterdam – June 26th 2015

SUMMARY

In cooperation with the_Duisenberg School of Finance

> *"I believe we should complement the new European rules for banks with a **Capital Markets Union**. To improve the financing of our economy, we should further develop and integrate capital markets. This would cut the cost of raising capital, notably for SMEs, and help reduce our very high dependence on bank funding." (*Jean-Claude Juncker, July 15th 2014, Political Guidelines for the Next Commission)

PROGRAM

"CMU: what could happen is happening now"

A world with our without banks: insights from history
by Simon Lelieveldt, payments expert and financial historian

Imagine the scene following up the CMU now under construction
by Graham Bishop, consultant EU integration

Alternatives to traditional bank channels: the importance of CMU for retail investors and capital markets (retail investors' and SME's access to equity markets)
by Bernard Delbecque (European Fund and Asset Management Association)

"CMU: do we like what we see happening?"

Debating session by ELEC-economists Graham Bishop, Linda van Goor, Paul Goldschmidt (former director European Commission), Vassil Karaivanov (Sofia University) and Paul Tang (Dutch S & D Member of the European Parliament).

"CMU: where's the evidence of what comes next?"

Trends in the structure of Europe's financial sector: who does what where?
by Dirk Schoenmaker, dean Duisenberg School of Finance

Does the EU succeed in its aim of financial integration? Are there monetary implications of CMU?
by Maria Demertzis (DG ECFIN)

What's next for CMU – wrap up
by Graham Bishop

Chairwoman: Linda van Goor, advisor regulatory communication, member ELEC Netherlands

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SUMMARY

ELEC's Monetary Commission convened at the Duisenberg School of Finance in Amsterdam on June 26th 2015 to discuss the challenges and opportunities of a Capital Markets Union (CMU). The CMU blueprint of the European Commission that is now in the making, wants to complement the traditional bank financing with a deep and integrated European capital market. It should unlock the capital which is currently frozen and put it to work for SME's and for the economy in general.

Some 30 participants – roughly half of them ELEC members, half of them Dutch bankers – held a very intense brainstorming, starting from a number of introductory presentations (see program above). It resulted in a good deal of shared conclusions … and conflicting point of views. On the central question whether the CMU will result in a world without banks, the unanimous feeling was: **banks will not disappear, they will change.**

Below some of the **main features** of the rich and daylong debate:

- Although the blueprint of the European Commission for a Capital Markets Union is still in the consultation phase, the CMU is **already taking place**. Alternatives to the traditional bank channels have increased since the financial crisis, despite policy makers and even outside regulation. All the European Commission can do, is facilitate the process.

- Barriers have been removed in the private and public sector, but the securities legislation has as yet remained untouched. The **difficult part is yet to come**. Up until now the Commission has only picked the low hanging fruit.

- The present shift from bank dependence to more market funding, reflects **the flow of history**. An analysis of the financial centre Amsterdam during the last 400 years, shows the constant renewal of players: first cashiers, then banks, then financial markets, back to banks and now the shift towards the CMU, re-opening markets.

- An additional element today is the importance of **technology**. The financial sector is raided by Silicon Valley. The smartphone opens a new world of possibilities. This is the end of fragmentation.

- The new technology is especially important since it is embraced by the **young generation**. At the same time, the young generation does not simply undergo events, it wants to influence developments, say sustainability.

- On the question how the CMU can attract savings that are now abundantly hoarded in banks, one element was constantly repeated during the discussions, be it under different synonyms: **"reputation", "confidence", "certainty", "trust"**. Whatever the name, this is the key to attract investors. Who is prepared to invest in the equity or bonds of an SME without knowing the owners that run it?

- On the contrary, the Monetary Commission was less unanimous on the question whether or not **payments** are of vital importance for the banking system. Are payments indeed the first motive for people to put their money in a bank, or can these easily be taken over by other players that will charge far less costs?

- In the shift from banks to markets, much will depend on the **number of countries that join the CMU**. The Commission intends it to comprehend the 28 EU member states. But would it not be more logical to confine its size to the countries that fully take part in the Banking Union and the Monetary Union? But in that case, the CMU would be limited to euro denominated financial instruments. It could lead to additional differences between the euro zone and the non-euro zone. This possibility brought about a discussion about Brexit and the vital importance of the CMU for the City of London. If London stays aside, will the money flow for example to Amsterdam, or could London be the place to develop a euro zone market?

- Related to this is the question whether it is possible to harmonise existing national regulations. **A "29th regime"** as an umbrella for the 28 national laws may be preferable. Changing the legal framework such as civil law and solvency law, is very difficult on the national level.

- If we want to give SME's a broader access to capital markets, **securitisation** is inevitable. But it poses a lot of challenges, it is not a miracle solution.

- This raises the question what player will make the **risk assessment**. The consensus at the Monetary Commission was that it cannot be left to retail investors. The role of banks will still be crucial. They have the information and will inevitably act as intermediaries between the retail investors and the big and small companies that are looking for capital.

- So the CMU, although it is said to be a substitute for bank financing, can be an enormous **new challenge for banks**. Not only can banks play an intermediary role in securitisation, they are already now trying to reconquer activities such as money market funds, crowdfunding, venture capital and business angels. Banks will not disappear, they will change.

- At the same time the growing importance of institutional investors is reducing the role of banks. The capital market will deepen given the rise in **pension savings** as a consequence of the ageing population.

- A theme that popped up numerous times during the discussions was the importance of **education.** The huge diversity and innovation of capital markets, poses an enormous educational challenge for investors. If selling securities to small investors results in higher risk, investors and the politicians will seek revenge if it turns out things have gone wrong.

- Let us **not compare too much with the US as a model** but build further on what we have. Take into account that Europeans are more risk averse. If in Europe we don't invest much savings into capital markets, this also has to do with our vast system of social security protection. We have relatively more SME's than the US. In the US the minority shareholder has a greater say since legislation protects him against the absolute power of the majority shareholder. And if so many European savers put their money in the bank, it is simply because they trust the government for its deposit guarantee system.

- But the **European reality** today is that SME’s that can’t find finance here, simply move to the US… And if ever we want to increase the size of the CMU – one of the objectives for a performant capital market – we need to attract foreign investors to Europe.

- Several times during the discussion, it was reminded not to forget that the prime reason to promote the CMU is that the European economy with its heavy reliance on banks, recovered more slowly from the financial crisis than the US with its more diversified model of market financing. Financial imbalances are the root of macro-imbalances. The shift from banks to markets should bring **more macro-economic stability**.

- Not only households will have to be convinced to unblock their savings in bank deposit and to invest more in capital markets. **European countries** such as Germany and the Netherlands (France is a notable exception) **are net savers**. Their banks have kept their money in the central bank, they are not investing. So the problem is not a lack of supply, but a lack of demand.

- Important as the CMU may be, it will take time. And it can only be a building block for a stronger Europe if first **other priorities** are fulfilled such as the completion of the Monetary Union and the Banking Union.

- Also the **debt overhang** has to be dealt with because the huge mass of non-performing loans hinders private and corporate investments. According to some participants, this is an absolute priority, according to others it must go hand in hand with an **investment agenda** so that countries can grow out of the present stalemate.

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