

## Financing Growth in the EU

### European Banking Summit – Brussels

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Ladies and gentlemen,

I am delighted to be here at the European Banking Summit to discuss the role of banks in financing growth in Europe, and I want to thank the European Banking Federation for inviting me to speak today.

The financial crisis laid bare some of the cracks in the EU financial system and spurred on a new wave of action to significantly reduce the risks of such an impactful event occurring again. In 2009, following the release of the De Larosière report, the establishment of the European System of Financial Supervision (ESFS) began – a fundamental altering of the framework and approach to financial regulation and supervision in the EU. Since then, through the creation of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), the EU has moved towards completion of the Banking Union, which creates a safer and far more resilient financial sector.

On the other hand, while making great strides in reshaping the regulatory and supervisory architecture in the EU, and establishing a single rulebook which sets the foundation for that, it was also necessary to consider how more stable, integrated and better functioning capital markets could contribute to fostering growth and innovation across the EU. This led to the launch of the Capital Markets Union (CMU) project in 2015. In line with the theme of today's event, I will focus on the progress made with this initiative, and the continued important role of banks, and why we must continue to work towards building better capital markets in order to provide for a resilient and prosperous Europe.

### **The need for strong capital markets in the EU**

The Commission's Green Paper on Building a Capital Markets Union, and subsequent CMU Action Plan, came at a time when the European economy was slowly recovering, but there were still a number of impediments that restricted the access to funding that businesses needed to truly grow. The Green Paper illustrated how, when compared with other jurisdictions, capital market based financing in Europe was underdeveloped and fragmented, and too much reliance was placed on traditional bank financing.

In order to achieve the ultimate goal of strengthening growth and stimulating investment in the EU, it was vital to develop stronger and deeper capital markets to allow funds to flow to European companies, thus benefiting the real economy. This is particularly important for start-ups and other unlisted firms, including SMEs, who have faced the greatest challenges in accessing financing and do not enjoy the same level of direct access to capital markets as large companies do.

For retail investors, the CMU aims to bring about enhanced competition and better transparency regarding the choices and costs of their investments. A deeper and wider CMU would provide European citizens with many more options for allocating their savings. This is vital for households, who currently do not have access to the necessary range of products and returns to grow their savings sufficiently for future plans, such as housing, education, and retirement.

More importantly, while it is vital to ensure better access to financing and investment opportunities for all corners of the European economy, the more diversified approach promoted by the CMU initiative can also help to create a more stable financial system as a whole. An integrated CMU can improve cross-border risk-sharing, thereby reducing or limiting the effects of regional shocks. Evidence shows that diversification in funding sources contributes to financial stability, illustrated for example by the fact that equity investment tends to be less volatile and less pro-cyclical than debt finance<sup>1</sup>. Stability inspires confidence, and with this confidence we can have a more efficient allocation of capital across the EU.

### **CMU progress**

There are a range of legislative proposals that stem from the 2015 CMU Action Plan. The various proposals are too numerous and detailed for me to discuss today, so instead I just

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<sup>1</sup> ECB FSR 2017, Lane and McQuade 2014, Milesi-Ferretti and Tille 2011

want to touch upon a few of the most notable initiatives in which ESMA has been, and continues to be, centrally involved.

- Prospectus

In June 2017, the new Prospectus Regulation was published. As part of the new rules that will streamline the process of raising capital in EU financial markets, the Prospectus Regulation will not apply to small capital raisings under EUR 1 million. Disproportionate associated costs of producing a lengthy and expensive prospectus for these types of issues will therefore be removed. Furthermore, Member States will also be able to set a threshold of up to EUR 8 million which exempts issuers from the obligation to produce a prospectus.

Under the Prospectus Regulation, ESMA has proposed a large number of simplifications and adaptations of the prospectus regime, aimed at maintaining a strong level of investor protection while also opening up new possibilities for companies to diversify their financing and reducing the administrative burdens associated with the prospectus regime.

Then in May this year, the Commission adopted a proposal for a new EU growth prospectus for SMEs and mid-caps which want to raise money across the EU. While the broad parameters of this growth prospectus have been set out by the co-legislators, ESMA has developed minimum disclosure requirements in order to ensure a proportionate regime for SMEs, based on an issuer's size and the complexity of its operations, and has balanced them against the needs of investors to have a reasonably complete picture of any prospective investment.

- Securitisation

The CMU initiative also introduced ambitious plans to revive the European securitisation market in order to reallocate risk more widely and free up the balance sheets of originators, without repeating the mistakes made before the 2008 financial crisis. The development of a simple, transparent and standardised (STS) securitisation market constitutes a key building block of the CMU. The entry into force of the Securitisation Regulation in January this year marks a significant achievement. The new Regulation, which applies from January 2019, consolidates previous legislation in this field. It establishes a framework for STS securitisations that will differentiate them from more complex and risky instruments, while also applying proportionate prudential treatment, including preferential capital treatment in certain circumstances. The Regulation also sets forth, among others, due diligence, risk-retention and transparency requirements for all parties involved in the securitisation process.

In order to ensure its smooth implementation, ESMA, as well as the EBA, have been working hard to deliver on a large number of legislative mandates that will further specify the more technical rules. ESMA's work in this area focuses on ensuring a high level of transparency and investor protection. To this aim, we have already submitted a number of technical standards to the European Commission, and continue to work on more. We hope that these standards can then be speedily adopted to ensure that market participants have the full range of information available in order to enable them to be compliant from the beginning of next year.

- Asset Management

While the Prospectus and Securitisation Regulations may be viewed as the most important milestones to date for the CMU, in the area of asset management several endeavours are underway in order to help increase competitiveness and efficiency in this sector - another key goal of the CMU Action Plan. For example, ESMA, along with EIOPA and the EBA, have been tasked with bringing greater transparency to the fees and performance of long-term retail investment products – work which is clearly linked to the CMU's goal of increasing the attractiveness of long-term savings products for retail investors. The introduction of PRIIPs and MiFID II has done a lot to improve the disclosure of costs and charges by fund managers to customers. Continuing to shine a light on this issue will increase investors' awareness of the net return of their investments, and the impact of fees and charges on the returns they can achieve. This will help European investors by providing them with a better basis to choose investments and properly understand the impact that cost and charges have on the end-return.

- FinTech and Sustainable Finance

Finally, I would like to briefly mention two recent developments intrinsically linked to the CMU, namely the Action Plan on FinTech and the Action Plan on Sustainable Finance. The EU has been proactive in embracing both initiatives, to ensure that we in Europe can be at the forefront of fostering growth and investment in these areas, within a safe and stable environment.

The FinTech Action Plan aims to facilitate the digital revolution in finance, everything from crowdfunding to cybersecurity, and to help innovators access capital, research and grow. On the other hand, the Sustainable Finance Action Plan has more altruistic goals – to incentivise the financial sector to contribute more in the fight against environmental problems, by incorporating sustainability factors into the investment chain, and making green investment choices more accessible for retail investors.

With specific actions and mandates set for ESMA in the Action Plans, we maintain a balanced approach to both – fostering the objectives of these plans, but also ensuring that any proposed measures are justified from a risk and financial stability as well as investor protection perspective. ESMA is committed to delivering on this important work, which furthers the advancement of the CMU goals.

### **The role of banks in the CMU**

I have spoken so far about the goal of the CMU in promoting safe, alternative channels of financing in order to reduce overreliance on one specific financing method, namely bank financing. However, I think it is important to acknowledge that, while the CMU initiative's aim is to increase the role of the non-banking sector in the EU, this should be seen as a healthy complement to, and not a replacement of, long established bank financing channels. Both systems offer different benefits, depending on the type of funding required. More importantly, as already mentioned, complementary systems of diversified funding means better risk sharing and lower volatility, especially in times of market stress.

The CMU initiative clearly acknowledges this fact - that bank-based finance is and will remain the key source of finance in the EU, especially for SMEs and households, given their proximity to, and knowledge of, local markets. A number of actions in the plan build on this reality and focus on how to enhance the capacity of banks to provide financing to the real economy. The revival of the EU securitisation market works to this aim, by providing a powerful mechanism for transferring risk off banks' balance sheets and increasing their capacity to lend. Similarly, the measures presented to address the risks related to high levels of Non-Performing Loans in Europe will lead to healthier bank balance sheets.

Moreover, banks play an essential role in the capital markets themselves as buyers and sellers of financial products, as members of clearing houses and other market infrastructures, as advisers to corporates in the capital raising process, etc etc. Therefore, it is important to be clear that it is not about BU vs CMU or banks vs capital markets – this is about complements not substitutes. We are talking about closely intertwined financial markets where specific firms play a variety of different roles in the capital raising and financial intermediation processes. As regulators and supervisors we need to be conscious of this closely interconnected network of players and their varying roles, as it also means that requirements targeted at one area might well have implications in another. Cross-sectoral cooperation and coordination, such as

through the regular interaction between the ESAs and through the Joint Committee, are therefore essential. [Why I happily accepted this opportunity to talk to you today.]

### **Strengthening supervisory convergence**

I have so far talked about the legislative proposals under the CMU. Let me turn now to the important area of convergence of rules. Supervisory convergence and consistent enforcement of the commonly agreed rules has to be a key part of the CMU in order to ensure investor protection, orderly markets and financial stability. True convergence will ultimately make it easier and smoother for market participants to do business across the EU, creating a level playing field of high quality regulation and supervision.

With the single rulebook taking shape, ESMA's focus has shifted from developing rules to ensuring a consistent understanding and application of those rules throughout the Union. In doing so, we use all of the tools available to us to further this goal. Amongst others, we issue guidelines, recommendations, opinions, Q&A's, and we also conduct peer reviews of national competent authorities, offer implementation workshops, share supervisory best practices, and so on ... All with the aim to establish common and consistent supervisory practices in the application of EU law. While we do not aim to achieve a one-size-fits-all approach, we strongly advocate the use of sufficiently similar supervisory approaches, including enforcement, for similar risks. The overall goal is to strive for comparable regulatory outcomes.

However, as our experience grows, and we identify more and more areas where convergence is not sufficiently progressing, it becomes even more important for ESMA to step up its efforts. To achieve this, we believe – based on our experience so far - it is necessary to enhance and refine these convergence tools, along with the governance of their use. This is something that is clearly recognised in the Commission's legislative proposals reforming the European Supervisory Authorities. Improvements to key tools, such as improving the independence around undertaking reviews of national competent authorities, complemented with changes to ensure enhanced independence also in the governance of our convergence work, is a step in the right direction. We believe that structural upgrades of ESMA's convergence tools should also go hand in hand with a stronger EU financial data strategy that could streamline the collection and usage of data across Europe.

Considering the progress made in harmonising the regulatory frameworks for capital markets in recent years, a greater push is now needed to accomplish consistent application and

enforcement of those rules. The CMU's ambitious goals will not be sufficiently achieved if we cannot commit to further levelling the playing field in the EU.

## **Building on Brexit**

The case for strengthening ESMA's supervisory convergence powers, and for progressing speedily with the CMU, has been reinforced by the UK's decision to leave the EU. The UK's decision means that Europe's biggest capital market will soon be outside of the Union, which has given rise to new challenges for ESMA and beyond. As negotiations continue, it is vital that the stability and functioning of the EU's financial markets remains solid. To this end, ESMA is closely monitoring the associated risks and, if needed, identifying possible mitigating actions.

From a supervisory perspective, it is vital to minimise any fragmentation arising from Brexit that can lead to regulatory arbitrage. ESMA is playing an active role in this area. To date, we have published general and sectoral opinions in order to address risks of regulatory arbitrage between the EU27 Member States receiving UK business. Through the opinions, we have re-emphasised important regulatory principles aimed at fostering consistency in authorisation, supervision and enforcement related to relocation without questioning in any way the freedom of establishment, one of the main pillars of the EU.

In addition, we felt that it was necessary to monitor how the principles outlined in these opinions were being implemented in practice. So we established a new 'Supervisory Coordination Network', which brings together experts from a broad range of competent authorities who table actual cases that they are facing involving UK entities looking to move to the EU27. This new forum is so far proving to be a successful and important means of information sharing and promotion of convergent practices.

With the UK soon to become a third country, the need for the rest of the EU to build bigger and better capital markets with diverse funding and investment opportunities is even more important. It should spur us on in our work on completing the CMU. Of course, as the UK will continue to be a critical partner of the EU post-Brexit, it is also vital that an appropriate framework for third-country regulation and supervision is in place. Based on the current EU equivalence regime, supervision of third country entities is conducted outside the EU, without the provision of any additional safeguards from an EU perspective. At the same time, many of these third country entities perform systemically important functions in the EU financial system. Considering the impact of the UK's withdrawal from the EU, and the associated emergence of

certain third country entities with a potentially significant impact on EU financial stability and investor protection, a common EU-level approach for supervision and enforcement of these entities should be put in place. This is something recognised by the ESAs review proposal, as well as the proposal for third country CCPs in EMIR 2.2. These are positive steps that should be, in my view, expanded to other key market infrastructure providers, to maintain and enhance the EU's relationship with third countries, enabling important global market infrastructure providers to continue to deal with EU market participants in a way that ensures safe and open European capital markets.

## **Conclusion**

Let me conclude by first stating the obvious – there is no doubt that the CMU is an ambitious project, and that more progress is needed. While many important parts have been delivered, implementation is still under way. Moreover due to the symbiotic nature of many of the key actions, we need to achieve more before we can truly witness the benefits of fully integrated European capital markets.

The arguments supporting the acceleration of the CMU have only become stronger. Fostering growth in a changing environment means that we need to continuously rethink our traditional ways in order to accommodate the needs of the economy, while mitigating any associated risks. Whether this is through embracing innovation such as FinTech and sustainable finance, or by simply providing citizens with better opportunities and choices to grow their hard earned savings, a common drive is needed in order to tackle the global challenges of the future. The prospect of Brexit has made our task even more urgent. While policymakers can drive the CMU agenda, it is vital that the vision for stronger capital markets is embraced by all, from households to banks, to make sustainable economic growth in the EU tangible in the long term.