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MORE OR LESS EUROPE?

CEPS IDEAS LAB

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Programme

Finance

CEPS Anchor & Moderator: Karel Lannoo

Have we solved the too-big-to-fail problem?

Discussion Leaders

Gunnar Hökmark, *MEP*

Europe has adopted a raft of measures to ensure that banks can be resolved or liquidated in an orderly way and no longer need to be bailed out with taxpayers' money. But scepticism remains that these initiatives will be enough to overcome the TBTF problem. This is also one of the motivations behind one of the few post-crisis measures remaining on the 'to do' list – the Barnier (or Liikanen) proposal to separate commercial and investment banking. Is such a measure still needed, however, after all the re-regulation in the financial sector? Who will decide on derogations from the proposed separation? And finally, is there a risk that separation, and the different approaches, will further contribute to market fragmentation and render banks more fragile?

Moderator: ***Maria Nieto,*** *Bank of Spain*

Which Union for Europe's capital markets?

Discussion Leaders

Fabrice Demarigny, *Global Head of Capital Markets, MAZARS*

Philippe De Backer, *MEP*

Europe has struggled for years to create a very liquid capital market as an alternative to the dominant bank–based model of financing. As an analogy to Banking Union, the European Commission has now set Capital Markets Union as an objective for the years to come. But what is Capital Markets Union? Would its creation entail a new wave of harmonising regulation? Or would it be preferable to undertake a series of initiatives to support and interconnect the fragmented markets in Europe?

The Nordic capital markets growth model

Discussion Leaders

Arminta Saladžienė, *Vice-President, Nasdaq OMX Group*

Allan Polack, *Head of Nordea Asset Management*

Nordic capital markets provide an interesting example of creating conditions conducive to the start-up of new ventures. Nordic banks are highly involved in investment banking activities, and the local exchanges have worked hard in recent years to improve the environment for IPOs and venture capital. In addition, the Nordic countries have a very peculiar corporate control model. This session will discuss what lessons their experience might offer to the EU to improve the functioning of its capital markets.

A paradigm shift in finance legislation

The paradigm in EU financial rulemaking is eight years after the Great Financial crisis shifting from avoiding reoccurrence towards contributing to economic growth. Many participants at the Finance Lab nevertheless expressed that further reforms are required to bolster the resilience of the banking sector. Whilst the European Commission's Capital Markets Union-initiative is encouraged to reduce the bank dominance, the scope seems to be too narrow to make a real difference. The Nordic experience with the development of sizable cross-border capital markets shows that more fundamental changes beyond financial legislation will be required to unlock the potential.

Have we solved the too-big-to-fail problem?

Europe has adopted a raft of measures to ensure that banks can be resolved or liquidated in an orderly way and no longer need to be bailed out with taxpayers' money. But scepticism remains that these initiatives will be enough to overcome the too-big-to-fail problem. Banks still have a competitive advantage due to (implicit) subsidies (e.g. government guarantee, deposit guarantee, and monetary policy). This allows banks to conduct activities that are not contributing to the real economy with taxpayer's money. Eliminating or offsetting these subsidies via risk adjusted premiums as well as a binding leverage ratio will be essential to address the moral hazard and to create a level-playing field with other financial sectors. The legislative measures should make sure that risk takers have both the upside as well as down-side of their decisions.

Which Union for Europe's capital markets?

Europe has struggled for years to create a very liquid capital market as an alternative to the dominant bank–based model of financing. The European Commission has now set Capital Markets Union as an objective for the years to come. The initial proposed measures (e.g. revision prospectus directive, securitisation), however, are too limited to make a real difference in diversifying the financial system as well as reducing the fragmentation in capital markets. The measures to enhance the trust of investors like insolvency and securities laws as well as taxation are on a back burner. Mistrust between governments and protection of national interest withholds governments from agreeing on these measures that contribute to more efficient and diversified financial markets. The CMU should also promote long-term investments. Long-term investments by retail investors are concentrated in certain institutionalised products (life insurance, pensions, etc.), while other savings are locked in low-return (insured) deposits.

The Nordic capital markets growth model

Nordic capital markets provide an interesting example of creating the deep cross-border markets. Nordic banks are highly involved in investment banking activities, and the local exchanges have worked hard in recent years to improve the environment for IPOs and venture capital. These markets have been primarily developed with a vast demand for capital markets instruments. The Polish equity market has, for example, become a regional hub for small caps due to a vast demand for domestic assets by pension funds, which are obliged to invest the majority of the private collected funds domestically. The Baltic exchanges are horizontally integrated, broadening the outreach. In Denmark, retail investors own a larger part of the securities. A beneficial tax treatment, integrated infrastructure and institutional backing make it attractive for retail investors to invest a larger share of their savings in listed securities.

Conclusions

Overall, despite the plethora of new banking and other new legislation in the past few years, the interventions in the Finance Lab showed that there is still a need for more legislative measures to improve the functioning of the financial system. Most of these measures that would unlock the economic growth potential are related to taxation, insolvency laws, and accounting. But also the financial sector legislation should be amended to incentivise the financial institutions to take the optimal decisions for society as a whole.

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