Speech given by Commissioner Jonathan Hill at the 2015 ECMI Annual Conference

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European Commissioner for Financial Stability, Financial Services and Capital Markets Union

Keynote Speech - Europe's Capital Markets Union: What is the 'long-term- view?

It’s a great pleasure to be at your annual conference and to have the chance to talk about the contribution that I believe stronger and deeper capital markets can make to the European economy.

But if we're going to take the long-term view, perhaps we should start by asking why Europe's capital markets are less developed than those of the United States. The answer is of course in part historical. The way that financial services have developed has been shaped by legal systems, custom and practice built up over centuries.

In Europe merchant banks had already built up an important role in the middle ages. That meant they were well established by the time industrialisation happened and well placed to finance economic expansion. From the end of the 18th century, European savings banks became the custodians of a growing volume of household savings.

With a strong banking sector, there was less of a need to develop capital markets in many European countries. In the US, banks only came into existence at the end of the 18th century. The need to finance the country's high public debt in the early 19th century helped the development of capital markets, while legislation brought in after the great depression limited the growth of banks. In Europe, two world wars hugely reduced the stock of capital that markets had to draw upon.

Europe's economy is today about the same size as America's, but our equity markets are less than half their size. In the US, SMEs get about five times as much funding from the capital markets – or non-bank financing - as they do here. As ECMI has pointed out, compared to the US, EU households have more than double the amount of their savings in deposits, but half as much in investment funds and shares.

Bank based financial systems can have real strengths like the relationship that banks can develop with local companies. But the crisis showed that our capital markets were not developed enough to fill the gap left by a bank sector unable to lend at normal levels. European SMEs receive 75% of their funding from banks; European companies are four times more reliant on banks than American ones. So a drying up of bank lending like the one we experienced in 2008 had a devastating impact.

This in part explains why attitudes towards the idea of increasing the role of capital markets in the European economy has changed. I suspect that a few years ago, had I said that my task was to increase the contribution that capital markets could make in the European economy, some of you might have raised a quizzical eyebrow. Today, I am glad to report that CMU is strongly supported by all 28 member states, the European Parliament and industry. The mood has changed.

The EU is now growing and recovering. Not as fast as we would like, but this year, we should see growth in 27 out of 28 EU members. Countries that at one stage needed EU and IMF assistance are now turning the corner.

This is good news, but we should not forget the broader context.

Last year the EU was responsible for around 15% of global trade in goods, compared to 18% ten years ago. We have 25% of the world's GDP, but 50% of its social spending. Just over 23 million people are without work, of whom about one in five are under 25. The structure of our population is changing. Today, for every person over 65 in Europe, there are around four people in work; over the next 50 years that figure will fall to two.

These challenges are what is driving me forward in my work to build a Capital Markets Union. We need deeper capital markets that can complement bank lending and support European growth.

At its most simple, a single market for capital aims to link savings better with growth. By building stronger, more sustainable capital markets, we could increase investment in our infrastructure; give businesses seeking capital a bigger choice of funding; increase opportunities for successful businesses to sell into bigger markets, reducing costs to consumers; and add to the options for people saving for the long term. And of course we could make the whole financial system stronger by diversifying away from Europe's traditional dependency on the banks. Evidence suggests the US bounced back quicker after the crisis thanks to a greater range of funding sources and deeper capital markets.

From the outset, I have been clear I wanted to build the CMU from the bottom up, step by step, rather from the top down. Why did I take this approach? First because I wanted to hear from others, particularly those active in the markets what steps they think we need to take to develop deeper capital markets and overcome barriers to cross-border investment. I didn't want an excellent blueprint but fail to make much difference on the ground. Next, and linked to that, I felt we needed to build confidence and generate momentum. For that to happen, we needed to identify some measures where we could make early progress and not get bogged down in institutional turf warfare. For me, being ambitious means getting things done quickly that will help make things better, not coming up with a plan that looks good on paper but stands little chance of being implemented.

That's why I started by consulting in order to flush out all the issues we need to tackle. We got responses from across the board and used that to draw up an Action Plan. It is broad in its sweep and ambitious in its scope. It addresses a whole range of measures which we will have to work through one by one in the years ahead.

Let me highlight a few areas.

At the heart of our action plan is a drive to build a system that meets the financing needs of European businesses at different stages in their development. We will look at how to remove barriers to small firms raising money from capital markets, and how we can better connect information on investment opportunities in SMEs to investors the world over.

For companies in their start-up phase, I am interested in new funding methods ranging from money-lending and donor platforms, to investment-based crowd funding or support from business angels. For companies in early expansion phase deeper venture capital markets would offer entrepreneurs more options. I also want to look at how tax incentives for venture capital and business angels can foster investment into SMEs and start-ups.

We also need to improve the connections between retail and institutional investors, the fuel in the tank of the CMU, to our companies and infrastructure projects.

We need better information and advice if retail investors are to invest on capital markets. Information should be available in a form that can be compared across investment products. This builds on steps we have already taken, but to check they are working as intended we will undertake a comprehensive assessment of European markets for retail investment products, including distribution channels and related services. The assessment will identify ways to improve the legislative framework and decide on how we best exploit the new possibilities for new advisory services offered by online providers and fintech.

We have a European system that allows investment funds to operate across the EU – but we know it does not work as well as it should. We have 36 000 UCITS funds in the EU, four times the number of mutual funds in the US, and of a much smaller average size. So I want to create a proper European passport system for investment funds to increase competition and choice for European citizens.

Personal pensions have the potential to inject more savings into capital markets and channel money to productive investments. Yet the EU has no single market for voluntary personal pensions. This means we are missing out on economies of scale which in turn limits choice and pushes up the cost for savers.

Next year, we will start the work to determine exactly what is needed to establish a European market for simple personal pensions. And clarify whether or not EU legislation can help to underpin that market.

The Action Plan also sets our approach to long standing cross-border barriers to the free movement of capital.

These range from differences in national laws on insolvency, tax and securities through to obstacles arising from fragmented market infrastructure. We know that progress will – by necessity – be slower. But I am committed to the long haul.

So we will consult on the key differences between insolvency and early-restructuring regimes across the EU. By the end of 2016, we will bring forward legislation to align insolvency proceedings better across the EU. We will also seek to address the current bias in our tax system that makes it cheaper to issue debt rather than equity.

We will work with the European Supervisory Authorities to strengthen supervisory convergence and keep a careful eye on the possible emergence of any new risks. Wherever you operate in Europe the rules of the game need to be consistent so that financial stability is safeguarded.

But I want to combine this long-term vision with urgent early measures to generate momentum and build confidence. So we're starting with a bang with six immediate initiatives.

Let me say a little more about them.

We are keen to encourage more long-term investment in infrastructure by institutional investors. So we will define what an infrastructure investment is under our prudential legislation – Solvency II - and lower the capital requirements associated with it by 30%.

Insurance companies have almost 10 trillion to invest in the European economy. At the moment, less than 1% of these funds are invested in infrastructure.

We want to relaunch European securitisation markets, in order to help diversify funding sources and free up bank lending for the wider economy.

To do that we have proposed a new framework to encourage the take-up of simple, transparent and standardised securitisation. This will define a set of criteria and apply lower capital requirements when a securitisation meets those criteria. If we can rebuild the securitisation market to pre-crisis levels, that would amount to an extra EUR 100 billion of investment for the economy.

We want to help SMEs get financing on capital markets. As part of that we will overhaul the Prospectus Directive. Prospectuses need to give investors clear information. But they also need to be affordable for SMEs to produce. We will propose a radical review before the end of the year.

We are also working on a package of measures to support venture capital. At around EUR 60 million, the average European venture capital fund is only half the size of that in the US, and around 90% of EU venture capital investment is concentrated in only eight Member States. In short, European venture capital lacks scale, diversification and geographical reach.

We will start by amending the Regulations on Venture Capital Funds and European Social Entrepreneurship to make it easier for more funds to participate, and be active in more investments.

To access large pools of international capital an enable more European projects to be financed, we are also taking forward work to develop a pan-European venture capital fund of funds.

We have also launched a call for evidence on the cumulative impact of rules in the financial services sector. Over the past five years, we had to legislate at speed while the fires of a crisis were burning all around. And as a result the financial system we have today is stronger. No one is putting that overall architecture into question.

But if you legislate at speed, in the middle of a crisis, you cannot expect to get every bit of regulation 100% right. So now, as we work to create an environment that supports investment, we need to check that the cumulative impact of these rules hasn't had any unintended consequences.

If hard evidence shows there are unnecessary regulatory burdens that damage our ability to invest, if there are duplications and inconsistencies, we should be ready to change things.The call for evidence will run for three months until the end of the year.

We also need to look at ways of encouraging retail investors to invest. So later this year I will be publishing a Green Paper looking at ways of increasing choice for consumers and of increasing the cross border supply of retail financial services. We need a system built on transparency, competition and choice that takes into account the development of digital services.

I think of CMU as a classic single market project, a project for all 28 Member States. The measures in the Action Plan set us on the path to do just that. It takes a long term view but aims to build the Capital Markets Union step by step - working with industry, Member States and the European Parliament - to identify problems and barriers and then overcome them.

Our commitment to the free movement of capital dates back to the treaty of Rome. So after half a century of effort, I am happy to be judged on the progress we have made in four years' time. I am optimistic about what we can achieve because of the political support I have had and the desire I detect to make early progress.

The scale of the difference we could make? If securitisation could be safely revived this could free up a 100 billion euro of extra credit to the private sector. If we could grow equity markets across the EU to bring the smaller ones up to the European average, 25 billion euro of additional capital could be raised each year. And there is great potential for growth in Europe's venture capital market that is a fifth of the size of the US and in our private placements market that is half the size. I do not pretend that progress will always be easy. But I do believe that we have a new opportunity to make our financial system more diverse and more resilient. It is an opportunity that I intend to seize.

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