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## **Capital Markets Union: Vital for Growth**

by Jonathan Hill

### **Speech**

It's good to be back at Eurofi and to have the chance to talk about the contribution that I believe stronger and deeper capital markets will make to jobs and growth.

First, some of the broader context. Amidst the challenges we face – the situation in Greece, market turbulence in China, the refugee crisis that confronts Europe – it is easy to overlook the progress that has been made. EU countries are reforming and are starting to see the benefits. Ireland grew 4.8% last year; Hungary 3.6%; Latvia 2.4%. These countries which all needed EU and IMF assistance at one stage, have reformed and are recovering.

This year we should see growth in 27 out of 28 Member States. Unemployment is falling. Our exports are competitively priced. We have a single market of some 500 million people, without tariff barriers, where workers, goods, services and capital can all move freely. We enjoy the rule of law which underpins investment. We have an educated workforce that produces goods and services the world wants to buy. We have world class universities and researchers, helping us to innovate to make our economy more productive and resilient. These are the foundations on which we now need to build.

And this is, of course, exactly what the Commission has been doing. It is why we have had a new drive on the single market to encourage a more competitive Europe. It's why we have a strong competition policy to make sure that the single market is fair and open.

It's why we have a big push on free trade – with the US, yes, where the potential prize is huge. But also with Canada, with Vietnam, with Japan.

It's also why we have brought forward the Juncker Investment Plan to help mobilise investment of €315 billion over three years. We are not yet one full year into the Juncker Commission, but the European Fund for Strategic Investments is getting up and running.

At the same time we need to take further steps to strengthen economic and monetary union, building on ideas set out in the recent 5 Presidents' Report. This is something I am sure Eurofi will be discussing a lot. These ideas range from the more immediate – strengthening the Banking Union; or a revamped European Semester for stronger coordination of economic policy. And in a later stage, looking at a more binding process of convergence.

Encouraging jobs and growth is of course a key part of my own portfolio. The first part of

my very long job title is financial stability; and we of course need that as the underpinning of sustainable growth. The reforms of recent years have, I believe, made the system more stable and more resilient.

But we need stability not rigor mortis. That's why we need to strike the best possible balance between managing risk and enabling growth; to make sure that EU legislation is proportionate. We have already started to look at individual pieces of legislation – for example the capital requirements for banks. But we also need to do something more comprehensive to look at the cumulative impact of different pieces of legislation to explore whether they are having any unintended consequences. I will be saying more about this in the coming weeks.

Reviewing our legislation fits naturally with the work I have been doing on the Capital Markets Union.

Since I last spoke at Eurofi, we have had strong support for CMU from the European Parliament and from the Council. They both recognise that it is vital for growth. They agree that we have identified the right issues. And that we are right to be taking a step-by-step approach.

CMU has three broad goals: first, to increase funding options for business, particularly SMEs; second, to create more opportunities for investors, and third, to encourage cross-border investment.

We clearly need to get the funding escalator for business working better, so that entrepreneurs have more sources of funding. We will be making a big push to encourage venture capital and also try to make it easier for companies to list. We will review the Prospectus Directive, which governs the information a business must provide when it offers securities to the public.

In terms of creating more opportunities for investors, we want to help give retail investors greater confidence, transparency, certainty and choice so that they can make the right investment decisions. We have made significant progress in recent years to increase transparency and improve disclosure standards. We will need to look carefully at whether this is improving results for consumers and ensure standards are consistent across products.

We will do some further work to investigate and, where necessary, remove persistent obstacles to the cross-border marketing of investment funds, so that consumers can have greater choice without the fees and barriers they currently face.

We will be coming out with a Green Paper by the end of 2015 in which we will look more closely at how to boost choice and competition in cross-border financial services for retail consumers.

We will also be looking to support institutional investors like life insurance companies and pension funds to play their role as natural long-term investors in European equity, venture capital and – particularly - infrastructure. We will come forward with proposals on revised

calibrations for Solvency II.

Encouraging cross-border investment is an area where progress will, by necessity, be more incremental. Although there has been a lot of progress in recent decades, there are still many obstacles standing in the way. These range from differences in national laws on insolvency, tax and securities through to obstacles arising from fragmented market infrastructure.

We will be looking at this area carefully, balancing the need to make good and early progress in some areas with the need to address these difficult long-standing structural issues.

We are on track to publish a detailed Action Plan later this month.

One early element will be measures to encourage the safe revival of securitisation. Securitisation markets are a key funding channel for the economy, increasing the availability and reducing the cost of funding for households and companies by opening up investment opportunities to a wider investor base, diversifying risk across the economy and freeing up bank balance sheets to lend.

Following the crisis, regulatory reforms were put in place to increase transparency, reduce reliance on ratings, and ensure originators kept skin in the game. In the US, markets have almost fully recovered, but in the EU, it's been a different story. Securitisation activity remains at less than half the level it was in 2007: over €200bn lower. This is despite the fact that losses on European securitisations were a fraction of those originated abroad.

Our aim is to revive markets on a more sustainable basis, so that simple, transparent and standardised securitisation can act as an effective funding channel to the economy. To do this we propose to introduce a set of criteria that securitisation instruments will have to comply with to be counted as simple, transparent and standardised, and thus to qualify for a more appropriate capital treatment.

One of the most basic criteria will be that assets packaged in securitisation instruments should indeed be simple. That means for example that the assets included in a securitisation should be sufficiently similar to each other. Also, no securitisation of securitisations (for example CDOs 'squared') would qualify as STS.

Synthetic securitisations will also not be included in our initial proposals because they can bring additional legal and counterparty risks that may not be immediately obvious to the investor. Complex synthetic products generated losses that were many times those generated by simple and transparent structures, where the record of European securitisations was actually very good.

I know that simple and transparent synthetic structures do exist, but precise criteria to identify them have not yet been developed. We are open to developing such criteria in the future; meanwhile for other types of securitisation an international consensus has been reached.

As part of the process, we will need to decide how to ensure that products comply with the

qualification criteria. I think originators, who have the most complete access to all information on the assets included in the securitisation, should take responsibility for the adherence to STS criteria rather than passing it to a third party. Similarly, I think it is right that investors should themselves take responsibility for the decisions they are taking. We must also ensure there are no conflicts of interest embedded in the new system.

So we will be proposing a three-pronged approach that combines responsibility on the part of originators and investors with close supervision by regulators and tough sanctions for rule-breaking.

We need early legislation on securitisation, infrastructure investment and on the prospectus to get our work on building CMU off to the best possible start. So I hope to have the support of both the European Parliament and the Council in getting this moving very quickly.

The aim with CMU is to complement – not replace - Europe's tradition of bank financing. Bank lending

will remain vital for our economies, especially when it comes to lending to small businesses and local infrastructure projects. That is why we have all worked so hard to help the banking sector recover in the wake of the financial crisis.

And a huge amount has been done. We have put in place a system for bank recovery and resolution. European banks have raised hundreds of billions of euros in order to strengthen their capital buffers. This not only will limit the amount of taxpayers' money that might have to be used in any future crises, but will help to underwrite sustainable lending to the economy and bring back growth to Europe.

But having put the architecture in place, we should also be ready to look at the how the detail is working out in practice. This is why back in July the Commission launched a consultation to consider the impact that our prudential rules – in CRR and CRD IV – are having on lending to the economy. We want to understand how these changes have affected banks' ability to lend to businesses in general, and more specifically to SMEs, infrastructure and other long-term investment projects.

I would encourage you to respond to this consultation which is open until 7 October. Let us have your experience and share with us any evidence of the impact that the new rules might be having,

We will use the input that we receive to prepare a report on the issue for next year. My goal in carrying out this review is to ensure that the banking system in Europe is stable and resilient, while also taking into account the overarching objective of supporting jobs and growth in the EU.

Ladies and gentlemen, the Commission has a bold and far-reaching agenda. More single market, more free trade, more structural reform, a stronger economic and monetary union, more competition, more investment and more capital markets. I am excited about the contribution that a bigger role for capital markets in the European economy could make to growth, increasing funding options, giving retail investors more opportunities, making the

economy more resilient. I think Capital Markets Union is vital for growth. And this is why I am looking forward to setting out our Action Plan in the coming weeks. Watch this space.

Thank you.