BANK CONTRIBUTION TO THE CMU

DENIS BEAU
First Deputy Governor - Banque de France

How can banks contribute more to the CMU (and vice versa)?

Everyone agrees with the benefits of the Capital Markets Union at a time where we need a better allocation of the abundant savings in the EU to help finance two decisive transformation, the ecological and the digital one. However, so far, the deliverables have remained too slow and disappointing.

How can we better and quicker move forward? One lever is to go beyond the complementarities between bank and non-bank financing. Such complementarities have already materialized through several dimensions notably since 2007.

Banks and capital markets acting as close substitutes are key enablers of financial stability. Capital market funding has indeed developed in the wake of the GFC to diminish overreliance on bank funding in the EU, which then happened to be procyclical. Conversely, during the covid-19 crisis, the banking sector has countercyclically substituted thinner market funding provided by MMF market or provided additional liquidity to the corporate and sovereign bonds markets.

Bank and non-bank financing channels also contribute to risk sharing in different ways, contributing to the financial stability of the system as a whole. Our companies, especially the most innovative ones, need to combine all types of funding for their financial soundness, consistently with their stages of development.

But banks are also important players in capital markets. They are investors (investment banking is still banking) but also originators and distributors of financial products through their dense commercial networks. In many financial segments, if not all, they are also the main market makers. Financial conglomerates play a decisive role in this regard.

However, taking advantage of CMU for their own needs, they could contribute more. A first "booster" could be a wider use of safe and transparent securitization, as a way to enhance both the banks balance sheets' velocity and the depth and breadth of financial assets available for investors. The upcoming review of the 2017 framework will provide an opportunity to make decisive progress in this direction, in particular regarding green securitization.

Going beyond the complementarities between bank and non-bank financing, to move the CMU forward quicker and better.

Another "booster" would consist in a rebalancing of financial activities on the Continent in the wake of the Brexit. Such rebalancing has already taken place in certain financial segments. It has to be confirmed and extended to central clearing activities. The European Commission gave several leads to achieve such a goal, including regulatory incentives, in its November communication. They should be pursued in the coming months.

CMU should conversely help boosting the European scale of individual banking groups, to optimize allocation of bank loans and markets funding within the European Union. The sound financial situation of the European banking sector in the aftermath of the Covid crisis facilitates such move.

Creating the CMU requires a strong banking sector, meaning banking actors reaching more systematically a European scale, for which Banking Union (BU) is an absolute cornerstone.

In this regard, without denying the political challenges related to the reinforcement or implementation of mutualized deposit guarantee schemes (i.e. the so-called "third pillar"), priority should be given to its reshaping, building both on increased liquidity solidarity between systems and reassignment of foreign subsidiaries to the home deposit guarantee scheme.

Thus, in order to move beyond home/host issues, an effective implementation of cross-border liquidity waivers within the EU could be promoted, combined with a preferential treatment for intragroup exposures in the BU. Last but not least, the forthcoming review of the crisis management framework could be a perfect opportunity to propose the harmonisation of bank bankruptcy regimes across the EU, in particular the depositors/creditors hierarchy.

All these progress, which are at hand, would provide, in conjunction with a stronger CMU, a genuine "Financing Union for Investment and Innovation", a powerful asset for our ecological and digital transformations.

CARLOS CUERPO CABALLERO

Secretary General of the Treasury and International Financing - Ministry of Economy and Digitalization, Spain

Banks as enablers in the Capital Markets Union

During the last financial crisis banks were severely shaken by ripple effects. The interbank market choked and a credit crunch was set off. European SMEs and households dependency on banks became evident.

This time banks are part of the solution and can provide crucial support to funding as the public stimulus programs are becoming more targeted. Reforms have made the banking system more resilient and ready to face economic turmoil. Moreover, banks can help deepen Capital Markets Union (CMU), acting as issuers, intermediaries of issuance and as investors.

The current context of low interest rates makes bank credit widely available. The most recent Survey on the Access to Finance of Entreprises (SAFE) survey by the European Central Bank reflects that firms across size classes anticipate a return to pre-COVID 19 loan supply levels. Spanish SMEs expect their access to bank loans to improve even further. In a first stage, banks contributed to the Spanish emergency economic policy response by granting more than €135 billion in public guaranteed loans to meet firms' liquidity needs, serving as a countercyclical element. In a second stage, the sector remains a key tool to ensure that credit correctly flows and that financing conditions remain stable.

Companies also have the opportunity to diversify their financing sources, and banks are well positioned to help them do so channeling unprecedented pandemic savings from retail investors to entities listed on stock markets. Many European banks have been very active in the capital markets in their current quest to diversify their income sources.

2021 has been a record year for IPOs in Europe. To strike a succesful IPO highly skilled advice is needed, and Europe will profit from retaining its competitive investment services industry. This is a good example of how banks can act as intermediaries, underwriting and placing financial instruments, but also as direct investors.

Another trend is banks setting up venture capital funds investing in start-ups in Europe. Some of these investments have paid off after the boom in capital markets and the emergence of many new unicorns. The Spanish authorities are aware of the need to further drive this change and have adopted the adequate regulatory framework with two legislative initiatives to promote the constitution and growth of companies and to remove barriers for start-ups.

Banks adaptation to sustainability and digitalization will be key to complete the CMU.

The CMU has embraced two pillars: sustainable finance and digitalization. And in both initiatives, credit institutions are key actors mobilizing the substantial volumes of private and public investments that the twin transitions require. Therefore, advancing sustainable finance within the CMU framework must be a priority. This implies addressing issues identified by investors such as market fragmentation of standards and accountability on the level of greenness or the availability of ESG financial products that match consumers' demands and are aligned to the highest standards. Given their close, trusting relationship with their customers, banks will have an increasingly important role offering ESG financial products for retail investors. Finally, until recently there were not many reference assets that are needed for pricing other sustainable products. Spain achieved an important milestone in 2021 with the first issuance of a €5 billion sovereign green bond. Demand was 12 times the amount issued, showing the large appetite for these bonds. This instrument was needed to push the green market to new frontiers in Spain and its greenium shows that environmental ambition is not incompatible with the economic rationale of a treasury bond issue.

Digilatization is a transformative force in the banking sector, delivering automatic, customized solutions to customers. This process coupled with the need to rationalize costs has led many banks to reduce their physical presence throughout the territory. Yet, there is the risk of leaving behind their less digitally literate customers, especially in rural areas. Digitalization should not lead to financial exclusion. Even though banks are already engaging in offering mobile branches and improved call centres more efforts are due.

A balanced solution between efficiency gains and social utility is necessary. In this sense, recent Spanish banking associations' commitment to issue a code of conduct to ensure the access of the elderly to financial services is a step in the right direction. Similarly, their engagement in social projects to improve financial literacy is also welcome. Capital markets will profit from this, since banks can allocate their resources more efficiently elsewhere and citizens are more knowledgeable and keener to participate in financial markets.

Banks have an important role in capital markets that goes well beyond traditional banking services. Their ability to adapt to sustainability and digitalization will be of paramount importance to their business, but also to the success of these initiatives in the CMU.

ROLF STRAUCH
Chief Economist and Member of the Management Board - European Stability Mechanism (ESM)

European financial integration: the role of banks in capital markets

European capital markets are fragmented and small when compared with the US markets. The larger role of capital markets funding is one of the reasons usually mentioned to explain the faster US economic recovery after the global financial crisis of 2008. 2020 and 2021 will surely be remembered as the years of the pandemic. I would wish this and the coming years will also be recalled as a turning point for capital markets in Europe.

The crisis has induced extraordinary policy responses on all fronts. Support measures were successful in preserving financial stability by maintaining credit flows to the real economy. As we are gradually heading out of the pandemic, emergency crisis measures are being phased out and market financing of the recovery and the twin transition to a more digital and sustainable economy will be crucial. Europe should focus on two priorities that, although connected, are different in nature: first, Europe needs larger and deeper domestic capital markets to overturn the endemic capital markets underfunding; second, Europe needs further integration of its capital markets.

Advancing the capital markets union (CMU) initiative is key to succeed on these issues. Banks could promote progress on CMU and also benefit from it. There is consensus on the pivotal role of banks in CMU and in the European economy: banks are direct lenders to a significant proportion of the economy and are intermediaries in capital markets.[1] A single market for capital in Europe is, without a doubt, beneficial for the banking sector.

More integrated capital markets open the possibility for more cross-border activities. Banks' holdings of domestic assets could be better diversified. CMU would also expand banks' investor base for their equity and debt issuances, which are crucial in increasing their resilience. In addition, a harmonised securitisation framework would support banks' efforts to make further progress on risk reduction. Since the risk exposure of banks is an important political consideration for the completion of the banking union, progress on the CMU initiative could support removing some unresolved deadlocks. Several of the recent deliverables of the 2020 CMU Action Plan – such as the proposal to amend the Capital Requirements Regulation (CRR), European Single Access Point (ESAP), and Markets and Financial Instruments Regulation (MiFID) reviews – have a direct or indirect effect for enabling banks' activities in capital markets.

Banks are best placed to turn savers into market investors.

Banks are in the drivers' seat to achieve better capital allocation in CMU

European banks are best placed to turn savers into market investors considering the size of savings sitting in bank deposits and the trusted relationship that clients have with their banks. For that to happen, banks need to provide more and better financial intermediation services including market making, both on a domestic and cross-border basis.

Banks constantly face the choice between intermediating between borrowers and depositors while retaining the credit risk on their balance sheets, or between issuers and investors where the credit risk is passed onto the investor. Unfortunately, there is not enough provision of investment banking services to SMEs, which complicates capital market access for these companies. Enhancing the capacity of European banks as intermediaries and market makers to support primary and secondary markets is key for financing SMEs during the recovery and the twin transition.

Banks' role in providing financial advice is of fundamental importance. Retail investors would benefit from access to independent advice, breaking possible conflicts of interest across the distribution chain. The low level of financial literacy in Europe is a problem. Financial education is a long-term objective and one cannot expect tangible and swift results in shifting savers into investors without help from banks. Banks can also be useful in providing direct long-term equity financing, which is increasingly relevant as companies' capacity to absorb debt is reaching its peak.

The CMU project can clearly benefit from an enhanced role of banks in the financial services industry and, in turn, integrated capital markets will provide greater space for banks' business. Importantly, financial integration, via CMU and banking union, offers risk-sharing mechanisms that can mitigate the impact of global or country-specific shocks and, therefore, contribute to macroeconomic stability. More private risk-sharing remains crucial within the euro area, where policy's space to address asymmetric shocks is limited. These projects would also facilitate the implementation of the Recovery and Resilience Plans, particularly investments and reforms aiming to promote the green transition.

[1] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Building a Capital Markets Union, European Commission, 2015, p. 21.

BERNHARD SPALT

Chairman of the Management Board - Erste Group Bank AG

Doing the right thing: developing capital markets to step up on climate

The latest round of legislative proposals concerning the CMU from November 2021 include the creation of a European Single Access Point (ESAP), making European Long-Term Investment Funds (ELTIF) more accessible to retail investors, introducing a consolidated tape and measures to enhance the integration of the Alternative Investment Funds' Market. These priorities illustrate that the focus of policy makers currently is on attracting more retail investors and smaller companies to actively engage with capital markets.

All measures currently foreseen will in the long run support the creation of a true CMU. For us, more capital market in the EU means to increase our economy's resilience by means of a more balanced financing landscape. Ideally we envision an EU where roughly 50 percent of the economy is financed through banks and the other half comes from the market. We believe that this will not only reduce financing risks but also reestablish a growth culture in Europe, especially when we think of equity investments. As examples from around the world show, only this will help to identify and grow our own Teslas, Alibabas and Apples from our outstanding pool of SMEs within the EU.

From our perspective, there is a lot that retail banks can do to support these ambitions. Fundamentally, banks have access to a large retail client base with substantial holdings of savings. As liquidity in our markets is currently not a matter of concern and will presumably not be in the foreseeable future, customers could put their funds to "better" use, inter alia by investing in the capital market. Banks can and should support this by creating appealing, easy-to-access products. This should be accompanied by measures to increase financial literacy among clients in order to enable them to make informed decisions in regard of their investments.

Our priority: linking capital market development and the fight against climate change.

Since Erste's foundation over 200 years ago as the first Austrian savings bank, we have been following the principle of making financial products and services accessible to everyone in society with the aim to disseminate prosperity. Assuming responsibility for our actions and offering our services to reduce poverty and social exclusion has been our purpose and guiding principle ever since. As one of the largest financial services providers in the Eastern part of the EU, we continue to create added value for people, the environment, the economies and, more generally, for the region and communities in which we operate. In this sense, we very much embrace the idea to increase capital market participation of both our retail and corporate customers.

A key contribution as a bank is to be a conduit between capital markets and sustainable investments.

But we have to take it further: securing the prosperity of future generations also means to reevaluate how we relate to the use of natural resources. At Erste Group, we understand that everything we do has an impact on the environment, which also includes our premises and the mobility of our employees. Most importantly, we believe that the nature of our products and services can make a real difference. Compliance with ESG standards is becoming one of the single most relevant aspects of investment decisions of retail customers. Hence, attracting people to invest their savings in the capital market will be increasingly subject to sustainability related considerations. At the same time, transforming our economy in a sustainable way is the greatest challenge of our time. Viewed from this angle, our most important contribution to CMU development will be to sustainably link capital market development to the ESG topic. Retail banks should act as conduit between the capital market and investments with the overarching goal to transform our economies in a sustainable way.

What does that mean in practice? A key element to go forward is to create more attractive products like ELTIFs with a dedicated ESG character. We should also think of private equity-based investment funds in the ESG universe with banks as anchor investors. We see the need to campaign for more capital market friendly taxation and regulation, especially when green investments are affected. We should specialize on supporting young, ESG oriented innovative firms to access capital markets. All of this should – again – be accompanied with financial education for both individuals and young corporates.

These efforts will be supported by our digitalization agenda, within which we aim to continuously improve our digital footprint, covering our clients' needs along the entire financial lifecycle. We believe that the future of capital markets very much hinges on our ability to facilitate digital access to products, along with relevant information and an attractive customer experience. In this respect we would appreciate the EU putting more efforts into cross-border aspects of digital product offering, meaning that national regulation will have to become much more streamlined to permit efficient product design and launches.

STEVE GANDY

Managing Director and Head of Private Debt Mobilisation, Notes & Structuring - Santander UK Corporate & Investment Banking

CMU: what can banks and policy makers do? Securitisation example

It is a desirable goal for European banks and policy makers to promote CMU in Europe in order to support the growth of the European economy as (hopefully) it emerges from economic drag of pandemic restrictions by providing businesses and individuals with a greater choice of funding. Both parties have a role to play. Below I offer a short list of considerations for both the banking sector and regulators to help achieve the goals of CMU, using some securitisation examples (which is my specialty) to illustrate my points:

What can the banking sector do?

1. Aim for wide distribution across geographic and investor types

I suggest that banks should make a conscious effort to cultivate new investors outside their home jurisdiction. Wide distribution reduces reliance on a small number of investors, promotes liquidity and gets new investors comfortable with the peculiarities of your home jurisdiction.

2. Strive for documentary and structural consistency across issue types and legal jurisdictions

Even though structures have to be adjusted to fit local rules, banks can harmonise disclosure and structure practices to "build a brand" that investors recognise and can compare. For example, our Santander Consumer unit has subsidiaries and affiliates in 12 European countries which have established regular securitisation programmes that strive to include common structural features and disclosure practices.

3. Commit to the highest level of disclosure transparency

Beyond legal requirements, especially with structured products such as securitisations. Investors value high levels of disclosure, both before and after issuance. This will build the bank's reputation and attract new investors

I offer a list of considerations for banks and regulators to help achieve the goals of CMU.

Distribute a greater portion of lending assets into capital markets, using various repackaging techniques. An "originate to share" policy will encourage more institutional investor interest in bank assets. We have all heard the statistic that 80% of financial assets in the USA are financed in the capital markets, while only 20% are financed by banks. It is the opposite statistic in Europe. Banking assets can be attractive investments for institutional investors, when packaged correctly, to meet institutional investor requirements and which comply with regulation. Securitisation can convert illiquid assets into tradeable securities which are not linked to the risk of the banks, thereby offering investors a diversified investment opportunity in assets that they would otherwise be unable to originate in jurisdictions where they may have no physical presence.

What should CMU and Banking Union initiatives be focused on?

1. Creating common rules to address varied legal requirements, tax and bankruptcy laws and restrictions within Eurozone countries. For example, the STS (simple, transparent and standardised) securitisation legislation was one of the first CMU initiatives that contributed to this process. Much is left to be done, as demonstrated by the many recommendations for improvement put forward by market participants as the European Commission conducts its Article 46 review of the legislation. But as the name suggests, the legislation went a long way to creating common rules for all securitisations across Europe, which in the long run will promote greater participation across Europe by institutional investors. The legislation creates a category of high quality securitisations – the so-called STS securitisations - which must comply with a series of required structural and disclosure criteria reflecting best market practice. These rules have promoted the standardisation and comparability of securitisations across multiple jurisdictions.

2. Regulators must build on this foundation to reduce burdensome and complex elements which create barriers to entry, recognise the high quality of STS securitisations in the liquidity ratio rules, correct punitive capital rules which discourage issuance and streamline the capital relief approval process.

Finally, let´s not forget that CMU and Banking Union complement each other as both aim to create a true single market for financial services. Completing the Banking Union, is essential to unlock resources, including the fungibility of deposits across Europe. For that, a European Deposit Insurance Scheme (EDIS) should be put in place. This will help European banks to increase scale and gain efficiencies, allowing banks to offer the same products and services across Europe. It is about further European integration, financial stability, and benefits for consumers.