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<u>Executive Summary</u>

Stefano Micossi, Director General of Assonime, introduced the 14th Annual European Financial Services Conference, which focused on the role of financial markets in promoting growth in Europe. He began by paying tribute to John Houston, co-founder of the conference in 2003, who passed away recently. Senior Partner at Kreab, Houston was a leading member of the conference event team throughout its history, and was organising this latest conference when he died.

The first keynote presentation looked at the European Commission's Investment Plan for Europe. **Jyrki Katainen**, European Commission Vice-President for Jobs, Growth, Investment and Competitiveness, said the plan aimed to modernise the EU economy and boost growth and jobs. The EU economy is at a special stage after the financial crisis, where growth is resuming but needs to be strengthened, he said. He talked in particular about how private financers could help future growth prospects.

The Investment Plan for Europe, announced in November 2014, is one of the first major initiatives under European Commission President Jean-Claude Juncker, and consists of three mutually reinforcing pillars. First, the European Fund for Strategic Investments (EFSI) aims to mobilise at least EUR 315 billion in additional investment over three years, maximising the impact of public resources and "crowding in" private investment. Second, the plan provides tools to help investment projects reach the real economy: the European Investment Project Portal (EIPP), an online marketplace where worldwide investors and EU project promoters can meet; and the European Investment Advisory Hub (EIAH), a gateway to investment support. The third pillar is to remove regulatory barriers to investment both nationally and at the EU level.

So far, over 60 projects have been approved in the fund's infrastructure and innovation window. For example, a wind farm off the Belgian coast will receive a EUR 100 million loan from the European Investment Bank, with the expectation of attracting a further EUR 500 million of private investment. The European Investment Bank (EIB) has agreed to provide GBP 108 million to support construction of a new GBP 350 million teaching hospital in Birmingham, England. A project to build energy-efficient residential buildings in France will get EUR 400 million in EFSI financing, with the expectation of the same amount of private investment arriving on top. That project should create nearly 6,000 jobs.

Also, some 150 000 SMEs and midcaps are expected to benefit from enhanced access to European Investment Fund (EIF) finance, which is distributed mostly via commercial banks acting as local intermediaries. In Italy, 25 banks have already completed an agreement on SME financing, which will provide financing to 44,000 Italian SMEs and midcaps.

Counting the SME and other agreements, there have already been 250 transactions under the Investment Plan. These have used EUR 12 billion of EU investment, which mobilise EUR 100 billion in new investment in 26 countries. That makes Katainen confident of reaching EUR 315 billion in additional investment within the next three years.

But he said the best financing and technical assistance can only go so far when the regulatory environment continues to be marred by bottlenecks to investment. The Commission has started to address a number of barriers, notably through initiatives to develop the Capital Markets Union (CMU) and further deepen the single market for goods and services, especially digital services. The CMU aims to offer more funding possibilities for businesses and to create rewarding investment opportunities for institutional and retail investors.

Session 1 was moderated by **Jeremy Browne**, a former UK Minister of State for Foreign Affairs, and currently the City of London Corporation's Special Representative for the City. The session focused on the CMU: The Commission has outlined a path to create fully integrated EU-wide capital market by 2019. This should be capable of financing and strengthening European products and services in the global marketplace, and make capital available across national borders and on affordable terms. This opening panel discussed the ways in which banks, investment firms, insurers and other financing platforms are adapting to the needs of businesses, innovators and entrepreneurs.

In opening remarks, **John Berrigan**, Deputy Director-General of the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA), said that before the financial crisis, talk of the CMU had been about efficiency. Since then, there has been a change in strategic approach. While the aim of a single capital market remains, the focus is more on shorter-term deliverables, which could build momentum in the market.

In September 2015, the Commission adopted an Action Plan of 33 actions and measures, aiming to establish the basis for a CMU by 2019. These include promoting cross border investment, and using indicators to monitor how this progresses; passports for venture capital funds; streamlining prospectuses; and developing corporate bond markets. All these he described as lower hanging fruit.

Among more difficult tasks, he mentioned three in particular. At present, different national insolvency laws create uncertainty and make it harder for investors to assess credit risk, particularly in cross-border investments. By building on the better existing national regimes, the Commission aims to develop rules that can help viable businesses in temporary distress restructure so that they get a second chance. Another issue is the harmonisation of national laws on securities ownership. This is a long-standing issue, which looks easy from the outside, but is made hard because the laws reflect deep historical traditions, and there is no common concept of securities ownership. Thirdly, withholding taxes are collected differently in Members States, often resulting in inefficiencies and double taxation.

Sylvie Goulard, an MEP on the European Parliament's Committee on Economic and Monetary Affairs, pointed out that the current popular mood in much of the EU had turned against the financial sector, with many people thinking that the EU was working on behalf of the big, the rich and the markets. Because of this, the CMU should perhaps change its name in order to highlight its ultimate goal of jobs and growth and not to give ammunition to Eurosceptics.

She also criticised the European Council agreement made in February to provide safeguards in the EU internal market for Member States that have not adopted the euro currency. The agreement came ahead of the UK vote on whether or not to remain in the EU, but it did not treat properly the relationship between the euro-area Member States and those not in the euro, Goulard said. So far, she said, the best advocate for Europe has been U.S. President Barack Obama, with no one in Europe – or in Brussels – making the case as effectively.

Lorenzo Bini Smaghi, the Chairman of Société Générale, raised questions about the premises of the CMU. The aims of efficiency and stability through a CMU of course make sense from a theoretical viewpoint: The U.S. economy recovered much more smoothly than Europe's because it was relying not just on banks but also had deep capital markets. Therefore, people assume that we should to some extent try to replicate the U.S. system, with its greater role for capital markets in corporate finance.

However, much depends on how the CMU is built. One of the key reasons for the efficiency of the U.S. market is the role of federal agencies, but some of these elements do not exist in Europe, something that could get in the way of the CMU. For stability, after the financial crisis people came to believe in the Anglo-Saxon idea that markets are better than banks – so it is acceptable to use tax payers' money to bail out markets, but not banks. However, markets might not actually be more stable than banks.

Smaghi also pointed out that U.S. capital markets had developed over the last 30 years hand-in-hand with the integration of the banking system. In Europe too, the effort to implement the CMU needs to follow a banking union, but he had the impression that Europe has been moving backwards in the banking union: Banks have been becoming more national and fragmented, and we don't yet see cross-border banks. Therefore, a prerequisite for a successful European capital market is a strong banking system, which needs work in Basel and Brussels.

Christophe Nijdam, Secretary General of Finance Watch, said that his organisation was broadly in favour of three-quarters of the Commission's 33 Action Plan measures, such as those to promote equity financing over debt funding. However, Finance Watch is particularly sceptical of the current framework on STS (simple, transparent and standardised) securitisation. It thinks this does not integrate the lessons from the crisis on tranching, skin in the game, synthetics, and maturity transformation on asset-backed commercial paper. Market prices of European securitisation have fallen in certain cases by 80 percent – but this is not because of regulation, rather because of the waning confidence of institutional investors.

He questioned whether equity loan securitisation would benefit SMEs: It has not been a success in the U.S., in the most developed and innovative capital market, so why would it work all of a sudden in the EU, which has a more risk-averse European culture? Nijdam cited a recent ECB study showing that the main concern for SMEs is a lack of customer demand, not a lack of credit supply. Instead of more consumer and mortgage debt, what's needed is more trust in the future so that citizens open up their wallets again. He also dismissed the argument that STS securitisation could make the financial system more resilient.

In the second keynote presentation, **Jes Staley**, CEO of Barclays, analysed Europe's economic challenges from the point of view of business finance. He said that for too long growth in Europe has been largely financed directly by banks through lending on their balance sheets. As a result, when European banks become troubled, investment capital dries up. Therefore Europe needs to make a transition away from bank lending towards financing from more diverse capital markets. These allow businesses and entrepreneurs to access a broader range of investors, such as pension funds, insurance companies and investment funds. Such a model has flourished in the United States, where major corporations issue debt and equity in a variety of forms to a diverse pool of investors. That will change banks' role in financing, he said. In future they will primarily act as intermediaries, bringing together the providers of credit with those seeking financing, rather than being the direct lender.

To lay the foundations for such a future, rules critical to capital markets must be standardised, so that they are consistent and predictable across Europe. Currently, insolvency laws vary greatly from jurisdiction to jurisdiction, making it hard for investors to evaluate investments. This restricts the pool of financing available to European corporations, and helps explain why Europe has such a stark lack of recent high growth firms. Standardisation is also critical for early stage risk finance, Staley said. At the moment it is difficult for a business in Cambridge to raise venture capital in Frankfurt or vice versa. As well as restricting both ventures and potential investors, this dilutes the expertise an investor can bring, and stops clusters from developing.

One factor undermining efforts to promote capital markets has been aspects of bank regulatory reform. For example, public policy has made bank loans cheaper and more flexible through a friendlier legal regime and lower capital requirements. In contrast, public policy has made capital market financing more onerous both for businesses and for bank intermediaries. Businesses seeking financing face complex regulatory issues and varying public disclosure requirements before they can access the market.

Finally, he said that European policy makers have to decide quickly whether they care who owns, runs and manages capital market intermediaries. European institutions accounted for well over half the investment banking market 10 years ago. But today, the three largest investment banks in Europe are all American, and U.S. banks account for half the European market, up from a third 10 years ago. If the trend continues, there is a risk that in the near future, Europe's capital markets become almost entirely dependent on firms domiciled elsewhere. The alternative prospect is for EU-domiciled and managed banks play a major role in the capital markets and compete with others around the world. That would ensure a level playing field for European firms to compete with non-Europeans in their home market. To achieve this, European governments need to work together to establish the needed regulatory cohesion and consistency, he said.

SWIFT CEO **Gottfried Leibbrandt** gave the third keynote presentation, in which he addressed the growing problem of cyber fraud. He was speaking after an incident in which fraudsters stole USD 81 million from the Bangladesh central bank, and called recent such fraud events a watershed for the industry. He said it was not an isolated incident as fraudsters had used the same methods in at least two other cases.

He said the incidents are serious because keeping money secure is a core business for banks in a way that it is not for retailers or telecoms providers for instance. If banks are compromised like this, they can go out of business. In addition, the incidents are a problem because the financial system is interconnected and operates on trust. He pointed out that SWIFT – its network, software and core messaging services – had not been compromised. Instead, the thieves had broken into the bank systems where the SWIFT instructions are generated and confirmations received.

That said, SWIFT wants to help solve the problem, he said. First, it aims to drastically improve information sharing among the global financial community – both demanding more information from its customers and sharing more with them. Second, it will harden security requirements for customer-managed software in order to better protect their local environments. It will also enhance its guidelines for customers; try to support banks' increased use of payment pattern controls to identify suspicious behaviour; and introduce certification requirements for third party providers.

Leibbrandt added that advances in innovation had greatly improved the banking experience over the last few years, both inside and outside the banks. But advances open the door for increasingly complex cyber threats. To combat this, security innovation is needed, such as new generations of pattern recognition, monitoring, anomaly detection, authentication and biometrics. He called on the industry to use the current crisis to emerge stronger, better and even more secure.

Session 2 was moderated by **David Reed**, Partner and Head of the Financial Services Practice at Kreab. The session addressed the radical change to the EU's regulatory framework for financial institutions since the crisis of 2008. Though some of the more recently agreed rules have yet to be fully implemented, the result has been greater transparency and oversight, along with stronger governance and higher capital and solvency reserves. However, some of the measures have acted as disincentives for long-term investment, working against the prospect of a stronger equity culture in Europe with less reliance on debt funding.

Carmine Di Noia, Commissioner of CONSOB, the Italian financial market regulator, addressed ways to increase cross-border shareholding. One such measure is the Transparency Directive, which was issued in 2004 and revised in 2013, and provides for a regular flow of public disclosure of regulated information.

But he said that more steps are needed, including less detailed rules and more disclosure – in other words better, but less, regulation. One problem he highlighted is over-long prospectuses that investors do not have time to study properly. As a result, they serve not as instruments for investor protection, but as instruments for anti-liability insurance.

José María Roldán Alegre, President of the Spanish Banking Association and Vice President of the European Banking Federation, said it is important to understand the strengths and weaknesses of the emerging new paradigms in regulation. One problem is complexity: Every time you go to a conference there is a new acronym, such as MDA, the maximum distributable amount (the maximum amount of dividends and other payments for institutions that fail to meet a particular kind of buffer requirement).

There is also a tension between two different approaches to regulation. On the one hand are very detailed rules and the safe harbour concept: so long as an institution obeys them, it is going to be OK. On the other hand, in a regime based on principles, an institution will be subject to more regulatory discretion.

Chris Allen, Barclays' Global Head of Regulatory Policy, said there have been significant changes for the good over the last three years, such as a reduction in the complexity of derivative products. At the same time, there has been greater regulation of capital and liquidity and an increase in running costs. He highlighted the importance of international regulatory consistency and coherence. Effective collaboration and understanding should not be underestimated in terms of their potential to drive European financial markets.

Jean-Pierre Pinatton, Chair of the Supervisory Board of Oddo & Cie, pointed to some unintended consequences of past attempts to improve the functioning of European stock markets. The idea for a single European capital market arrived in the early 1990s, but around the turn of the century it became clear that it needed some work. The result was the Markets in Financial Instruments Directive (MiFID), which provides harmonised regulation for investment services across the European Economic Area.

Coming into effect in 2007, the directive aims to increase competition and consumer protection. To reduce the cost to investors of coming to the market, the big exchanges' monopolies were ended and liquidity was dispersed in various trading venues. However, there has been no real reduction in costs, as the exchanges' monopolies were replaced by an increase in the price of data – of which they have a full monopoly.

Work is ongoing on a second version of MiFID. One goal is to win back 95 percent of transactions to the lead market in such a way that the market pricing mechanism operates properly. Others are to stop abuse by high-frequency traders and to protect investors from being sold products that are not properly designed for them.

Felicia Stanescu, Policy Assistant to the European Commission's Director General for Financial Stability, Financial Services and Capital Markets Union, explained some of the background to a call for evidence on financial legislation launched in September. The consultation aims to get feedback on things like the benefits, unintended effects and consistency of legislation adopted in response to the financial crisis.

One reason is that markets and regulations are interconnected, so rules do lots of things at the same time: they regulate products and service providers to ensure these are safe for consumers; they regulate processes – such as trading, clearing and settlement – to ensure that transactions are executed safely and reliably. That means there’s potential for frictions, inconsistencies and overlaps, all the more so since a lot of legislation was passed very quickly. Stanescu said that almost half of the answers to the call received relate to cross-legislation issues, such as inconsistencies in disclosure requirements.

Another topic is the trade-off between regulatory stability and correcting things quickly because they don’t work or have unintended consequences. On this, there are sharp divisions between people calling for quick change and those saying it is too early or arguing for a pause.

The final outcome of the call for evidence will need to balance different stakeholder interests – those of the industry, consumers and supervisors. However, the Commission will take a targeted approach to action and look at everything on a case-by-case basis. Stanescu emphasised that the call for evidence was not aimed at a big system overhaul, but was looking very pragmatically at unintended consequences and seeing whether the same objectives can be achieved in more growth-friendly ways.

The lunch session was moderated by **Roger Hollingsworth**, Executive Vice President and Managing Director for Global Government Relations of the Managed Funds Association. Globalisation means that Europe's political, economic and social outlook is tied to developments elsewhere. That means that the EU must take into account international questions spanning the smooth functioning of financial flows. It must also monitor and respond to systemic risks and reinforce the protection of data security.

Anthony Luzzatto Gardner, U.S. Ambassador to the European Union, said that progress has been made since 2009 in repairing and reforming the world financial system. In particular, the EU and U.S. share a common goal of ensuring the highest global common standards.

The G20 summit in Pittsburg in 2009 aimed to not just repair the damage of the financial crisis, but also to create a safer and more stable financial system. Leaders agreed to improve markets such as over-the-counter derivatives, an agenda that was elaborated at subsequent G20 meetings. The U.S. has played a key role in moves to shore up bank balance sheets: 80 percent of banks now meet or exceed new liquidity standards. Another task is to plan the orderly resolution of G-SIBs – banks on the global list of systemically important banks – in a way that minimises the risk of loss.

The U.S. and EU have discussed financial regulation since 2002 through the Financial Market Regulatory Dialogue (FMRD), which meets biannually. It brings together representatives of the European Commission, U.S. Treasury and other European and U.S. regulatory agencies. The FMRD meeting in February this year launched negotiations towards a covered agreement on prudential insurance matters. It also acknowledged the progress being made on transatlantic cooperation in audit oversight. This has already produced agreement on joint inspections, including certain forms of reliance, and a commitment to avoid unnecessary duplication of work.

New transatlantic challenges include cyber security. Gardner noted that Treasury Secretary Jack Lew had said that the U.S. must continue to lead efforts to reform the international financial regulatory system. U.S. leadership in this area has already led to more rigorous capital standards for banks, greater transparency in the derivatives market and stronger tools for managing the failure of financial institutions. From now, the focus must shift to implementation and significant emerging threats.

In response, **Karel Lannoo**, Chief Executive Officer of the Centre for European Policy Studies, agreed that there was still a lot of work for the G20 to do. Looking at the Financial Stability Board (FSB) website, he is sometimes concerned that they are looking for new issues. What's more important is to work on and implement things that were agreed in 2009, such as work that still needs to be done on derivatives.

He said it was important to see how China implements Basel III – the latest version of the global, voluntary regulatory framework on bank capital adequacy, stress testing, and market liquidity risk. The G20 provides a structure for peer pressure over implementation, he said. Other important issues include long-term finance, green finance and shadow banking.

In Europe, next year will mark 25 years of the single market, during which enormous progress has been made, Lannoo said. However, a lot remains to be done. It is still to be seen whether the structure in place for the single resolution board will work. Also, the European Commission is not as active as it should be in many of these areas, he said. It has been reluctant to give more powers to the European Securities and Markets Authority (ESMA), for example. He said that a look at progress in the U.S. over the past century indicated that Europe needed to take a much bigger step forward.

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