Executive Summary

John Houston, Senior Partner at Kreab, introduced the conference, which was held amid a range of major developments for EU financial regulation: there is a new European Commission and a new Parliament, and important bodies have recently formed, such as the Single Supervisory Mechanism of the European Central Bank (ECB) and the Single Resolution Board.

Stability and prudential provisions became the priority after the crisis of 2008, and the financial sector's capitalisation and resilience have been greatly strengthened, he said. The challenge now is to marry this with efficient capital markets that support growth and employment.

The opening keynotes – from Commissioner Hill and Barclays CEO Antony Jenkins – noted the winds of change in Brussels with the arrival of the new Commission and Parliament. They highlighted the challenges facing the European economy and presented their visions of how the policymaking environment should be shaped to react.

Session 1 looked at Europe's Banking Union. How has Europe's banking system emerged from the stress tests and asset review conducted by the ECB? What impact are the plans for Banking Union having on the strength of Europe's banks? If EU institutions pursue banking structure legislation, will this reinforce confidence? Or does it instead risk hindering financial market integration?

The next keynote presentation and Session 2 looked at the Capital Markets Union. It has become clear that financial services need to be a part of a solution to Europe's growth problem. So what role can a capital markets union play? What aspects of capital market financing should be prioritised? Are the roles of banks and non-bank players being changed? And would this be a good thing?

The Lunch Session focussed on the role of corporate governance and transparency in maintaining global financial stability. How important is governance, and what is the role of transparency? Can the business culture in large financial institutions be changed? And how effective is self-discipline likely to be? Can individual jurisdictions legislate alone without damaging their international competitiveness? And how can harmonisation of rules bring about transparency?

In the first keynote address, **Jonathan Hill**, European Commissioner responsible for Financial Stability, Financial Services and Capital Markets Union, outlined the approach of the new Commission, his own portfolio and the future of the Capital Markets Union.

The Commission formed in 2014 has a new structure of Vice-Presidents, which aims to focus on a smaller number of priorities. The biggest of these is to create more jobs and growth in the EU – something that Hill said was urgent, given that 24 million Europeans are out of work.

To this end, the Commission's first act was to launch a 315 billion euro investment plan. It is also negotiating free trade agreements, including the Transatlantic Trade and Investment Partnership (TTIP) with the United States. The Commission is also striving to promote single EU markets in areas such as energy, digital services and capital markets.

Hill said the Commission is approaching regulation differently too. New legislation needs to be justified before other Commissioners, with the result that the amount of new legislation brought in 2015 will be one fifth that in a typical previous year. In addition, more existing laws will be reviewed – more than two and a half times as many as was usual in the past.

Under his portfolio, Hill will aim not to burden smaller, lower risk institutions with the same requirements needed for bigger, riskier ones. In addition, he will consider how best to deliver benefits from a single market in financial services directly to consumers. That means thinking from their point of view, and identifying barriers that stop them benefiting from competition.

A single market for capital will make Europe more attractive to inward investment, Hill said. It will create more financing opportunities for SMEs and infrastructure projects, and encourage long-term investment. While Europe already has a financial network, this needs better connections in order to become faster, more developed and more efficient.

Revitalising Europe's securitisation market could broaden the investor base to include more long-term investors such as insurers and asset managers. The Commission also wants to support institutional investors to invest in long-term projects. Hill suggested moving towards a single market for personal pensions, which would help mobilise more personal pension savings for long-term financing.

The Capital Markets Union (CMU) could also help institutional investors put their money in infrastructure – roads, bridges and broadband networks. The new European Long Term Investment Funds (ELTIFs) will provide a vehicle for such investment, Hill said. A task force working on the Commission's investment plan will also help make infrastructure projects more transparent, so that investors can more easily identify strong projects.

Finally, Hill said, CMU can also help small and medium enterprises (SMEs) to get access to finance. In particular, some SMEs might benefit from listing on a growth market or attracting venture capital, so their awareness of alternative financing should be raised.

Barclays Bank CEO **Antony Jenkins** began the second keynote address by pointing out how people tend to attempt to fix problems using existing models. Current economic problems – over-indebtedness, short-termism, and excessive exuberance – are not new, he said. But the old model for dealing with them would no longer work. Instead of asking how to restart the housing market and where to find new business debt, Europeans should instead try to face up to challenges within the new reality of a competitive global economy.

Jenkins pointed out that global economic growth is going to be structurally lower than before. Combined with demographic change, this means that growth will no longer happen automatically in developed economies.

One key to success is to be smarter about identifying and incubating innovation, he said. As well as happening when a company is set up to commercialise a new idea, innovation also happens in businesses with a long term track record. Increasingly, value creation is separated from where the physical manufacturing happens. That means western companies can compete by focussing on the design of the product, which creates much of its value – and not on manufacturing.

An economy based on innovation will require plenty of finance to enable development, Jenkins said. Contrary to popular belief, there is not a dearth of funding to SMEs – but there is a problem in getting finance for risky projects, particularly when these are carried out by smaller businesses.

A new Innovation Economy will have to lean heavily on capital markets, he said, adding that these will be boosted by the Commission's initiatives for securitisation and private placements. Better still would be the creation of a single European market for venture capital. This would involve harmonising venture capital schemes to make it easier for businesses and investors to find each other across borders. He said it is currently hard for a business to raise its first round of venture finance in one country, and the second elsewhere.

The new global economy could help create skilled jobs, but automation and international supply chains will threaten less skilled work, Jenkins said. That makes it imperative to train the European workforce in the skills needed in the new era. In particular, technical skills like science, technology, engineering and mathematics are in demand – but current education systems are not producing these.

Simply amending the old educational model will not fix our unemployment and low productivity problems. So young people should be encouraged to develop skills like computer code programming, Jenkins said. Beyond this, the mainstream curriculum should include business management, marketing and accounts, so that young people with ideas have a good chance of succeeding.

Session 1 was moderated by **Peter Spiegel,** Brussels Bureau Chief of the Financial Times, who pointed out that two years earlier there had been fears that the ECB assessment would force banks to raise hundreds of billions of euros. But concerns over this disappeared rapidly, which he said reflected the credibility brought to the process by the ECB.

Koos Timmermans, Vice-Chair of ING Bank, said that the ECB's comprehensive assessment exercise had been thorough and convincing, and that ING is happy with the way it worked. He added that the operational side of the single supervisory mechanism was in full swing, and that his institution was dealing with a large number of detailed requests.

One issue for ING is the rules on liquidity coverage. Timmermans said he was hoping that under new rules, it might be possible to create a single liquidity subgroup, to avoid locking up too much liquidity in different countries. He also said that the future would see fewer visits to bank branches by clients, but more personalised electronic communication in order to keep contact with them.

Ignazio Angeloni, a member of the ECB's Supervisory Board, summed up the comprehensive assessment of the banking system that the ECB conducted in 2014, and laid out the main challenges being faced now.

He said the exercise had been rigorous in comparison with similar exercises conducted elsewhere, including the U.S. Based on the positions of the 130 largest banks in the euro area as of 31 December 2013, a severe stress scenario would deplete their CET1 (Common Equity Tier 1) capital by about 260 billion euros. This would lower the banks' median CET1 ratio by 4 percentage points, from about 12% to 8%. An asset quality review (AQR) showed an increase of 18% in banks' non-performing exposure, relative to the initial values.

Finally, the ECB identified 25 so-called shortfall banks, which required immediate action in terms of capital adequacy. The total shortfall was 25 billion euros. However, since the date of the assessment, 12 of these 25 banks had covered their capital shortfalls by increasing capital by 15 billion euros. So there are currently just 13 such banks, with a total shortfall of about 10 billion euros.

Angeloni cautioned against focussing solely on the shortfall banks, as the stress impact on capital was significant on other banks too. They have since been taking autonomous action to raise capital. He concluded that the banking system overall is sound, but that there are individual cases that need to be addressed urgently. Globally, banking systems are moving towards higher levels of capital due to recognition of the role played in the crisis by scarcity of capital. But quality of capital is still an issue in some areas, and the ECB will tackle this from now on.

Francisco Uria, Head of Financial Services at KPMG Spain, said that 2014 had been an historic year for the European banking union. Agreements had been found on the banking resolution framework and the single supervisory mechanism, and the comprehensive assessment had been completed.

He said that now is a good time to stop for a moment and think about the effect of regulations already decided, including a reflection on regulation in the United States and globally. The key point to consider is whether regulations are helping banks to fulfil their role helping create jobs and growth – that is, whether or not regulations are making it easier for banks to lend to fuel growth.

He pointed out that the ECB's supervision priorities were based on capital, liquidity, corporate governance and business model. There is already a lot of regulation on capital and liquidity, so banks have a common base. But corporate governance and the business model are trickier. Detailed regulation has not yet been seen, he said. Plus, different European countries have different legal frameworks and cultures.

The winners in the new era will be banks that use technology to transform their business models, Uria said. That makes it important to invest and innovate more than before. Banks, in particular, need to find a way to make a profit while interest rates are zero or negative, which is a new scenario for them.

Elke König, Chair of the EU Single Resolution Board (SRB) said the time has come to switch the focus from new regulation to implementing and assessing the impact of regulation. Still, there should be no return to the pre-crisis environment, with an over-emphasis on being friendly to business, she said. A pendulum normally swings, it should stay somewhere in the middle rather than going from one extreme to the other.

She said the banking union needed its three pillars – the single supervisory mechanism and the single resolution mechanism – as well as a harmonised deposit guarantee scheme – drawing attention to the fact that a single supervisor has to know what to do if a bank needs to be resolved.

As a result of the new mechanisms, markets are already assessing banks differently. They are more confident in banks' ability to deal with problems themselves, rather than relying on an implicit state guarantee to bail them out in case of trouble. Now, if a bank hits trouble, it will have to look for a private solution, such as raising capital, restructuring the business or deleveraging the balance sheet. And if that does not work, it will go into insolvency like any other business. She said that accessing the single resolution fund is the last, and not the first, resort.

Xavier Rolet, CEO of the London Stock Exchange Group, started his keynote presentation by saying that growth is an urgent issue for the European Union: a lack of growth would destroy the social contract.

Big blue chip companies can contribute to growth, he said, but they are not the solution. At best, in good times they only maintain the stock of employment. The real source of innovation and job creation is SMEs, but they often have trouble accessing the right type of capital at the right cost. That is partly because the single market of financial services does not exist yet in Europe.

European businesses depend overwhelmingly on bank lending. However, this comes with risks for banks – if a start-up goes bust, for example – but limited rewards. It is very difficult for banks to leverage balance sheets to fund risky assets, Rolet said.

With equity, however, the investor takes the risk of bankruptcy but gets unlimited potential return. However, fewer than 1% of European companies tap capital markets, he said. One problem is taxes on equity, which can be imposed four times – corporate, income, dividend and transaction taxes. Another is regulations that mean it takes a long time to get a prospectus to market. He said that to get investors more involved in SMEs, a lot of work needs to be done on connectivity, information and networks.

Stephen Fidler, Brussels Editor of the Wall Street Journal, moderated Session 2, and he started by saying that the approach of the Commission towards the capital markets appeared to be pragmatic. Rather than making the best the enemy of the good, the ambition seems to be to absorb, understand and unclutter the financial legislation of the last five years.

Martin Merlin, Director of DG Financial Stability, Financial Services and Capital Markets Union in the European Commission, said that an efficient financial system is a necessary, but not a sufficient, condition for growth. The current challenge is to make it more stable and more transparent. That means regulating less than in the past, something the new European Commission has stated as a goal. Legislation should also be evaluated to make sure that it does not lead to undesired outcomes.

The Capital Markets Union is essential for growth because of Europe's debt overhang problem, he said. That means that investment for growth needs to be done through equity. Moreover, some countries have significant funding constraints, and they should not be confronted with a funding gap when the economy picks up.

Cyrus Ardalan, Vice-Chairman and Head of Public Policy at Barclays, called for a holistic approach to the financial ecosystem, which would include bank finance, as well as other kinds of debt and equity. In looking at the Capital Markets Union, a focus on products such as securitisation, while welcome, should not lead us to neglect to examine the fundamental drivers of capital markets activity and what might be limiting that activity in Europe.

He highlighted three drivers, the so-called 3i's: Issuers, investors and intermediaries. What are the factors that encourage people to issue? What motivates investors to invest? And who brings those issuers and investors together?

Luc Vansteenkiste, Chairman of EuropeanIssuers, noted that everybody sees in the Capital Markets Union the potential for fundamental changes in how people access financing, as well as in its cost and effectiveness.

Still, he said, there is a fear that the European Commission will not be able to change in the way that Hill outlined, and that old habits of over-regulation will remain. In addition, member states have a tendency to do things their own way: for example, some are talking about launching a financial transaction tax, while others are not. As a result, he said, expectations are limited.

One problem in Europe is that corporations have always based their thinking around growth, because they were used to an environment where they could sell more products to more customers each year. But growth has slowed, and business is instead focussed on innovation, which tends to come from new companies rather than established businesses. In the United States, he said, almost all the job growth is coming from young companies that are innovative, entrepreneurial and risky.

It is therefore essential to figure out how those companies can access capital – and preferably equity rather than debt. Though seed money is often available to start-ups, and investment from a venture capitalist after that, financing in the next phases of growth is often more difficult, he said.

Roger Hollingsworth, Executive Vice President and Managing Director for Global Government Relations of the Managed Funds Association, said that the current stage of reform provides an opportunity to rethink how to regulate financial services in markets and the future role of financial services. The Capital Markets Union should help unlock liquidity and put it to work in support of Europe's businesses, he said – particularly small and midsize enterprises.

In addition, the development of a CMU in Europe can further the European Commission's goals of stabilising the financial system and making it safer and more transparent. For example, at the height of the crisis in the U.S., the President could appeal to private capital market participants to buy off toxic assets sitting in banks, in order to stave off a financial collapse. He could only do that because of the robust private capital market system in the U.S., which meant there were private equity and capital market participants who were ready to work with the Treasury. For Europe, Capital Markets Union will be an important tool in building a less risky system for the future.

Hollingsworth emphasised that a Capital Markets Union will not be a competitor of the banking system, but will complement it. Capital market participants rely on banks much like commercial entities do, he said. Eurozone bank assets are vastly bigger than those in alternative investment funds, so it will not be possible for capital market participants to play any role other than a complementary one to the banks.

Yann Le Pallec, Executive Managing Director of EMEA Ratings Services at S&P, said that the problem of insufficient investment was due to a lack of demand rather than of supply. Companies in Europe are investing less than those in the rest of the world, and investors say there aren't enough projects because of the constraints on national budgets amid high government debt. Therefore the Capital Markets Union will not be a silver bullet, and might not have much impact in the short term, he said.

Big European companies do not have a problem accessing capital, but they operate globally, so the jobs they create will also be global. That makes the role of SMEs in job creation all the more important. But SMEs in some regions have difficulty in getting funds on a sustainable basis, he said. The key to getting investors to lend to them is transparency – meaning access to information across the EU.

Infrastructure investment is an effective way to boost the economy, Le Pallec said, citing research that infrastructure investment across the EU had a multiplier effect in economic activity of 1.4. However, this only holds when all countries invest in infrastructure at the same time. If, say, only Germany boosted its infrastructure spending, this would have a limited effect on the rest of the EU.

Moderating the lunch session, **Stefano Micossi,** Director General of Assonime, said that the financial world would have to demonstrate its ability to do things that are necessary if it wants to claim that regulation is not needed. He said a key task is to show that governance and self-regulation can ensure fairness, accountability and stability in the financial markets.

David Wright, Secretary General of IOSCO, said that the European Commission is right to push for a broader-based financing system in Europe. One reason for the quicker U.S. recovery from the financial crisis was its wider system, as well as faster and more decisive decision-making at critical times. He added that securities regulators worldwide are thinking in similar ways now, as they have realised the necessity of a broad-based financing system with deep capital markets. However, this kind of project has been trying to get off the ground since the 1990s, he pointed out.

Europe's slow growth and high unemployment make action more urgent now, as ugly political extremes have been growing, he said. One technique might be to try for a political agreement on a few priorities between the Council, the Parliament and the Commission. The deadline for delivery could be fixed – say, the end of 2016. If political momentum and belief in Europe start to grow, investment will follow, he said.

Wright said that coordination of trade repositories could be an effective way to increase transparency. These gather data on derivatives trading, giving securities and prudential regulators a real-time picture of exposures and market developments. Currently there are 25 of them, but they are not connected in such a way as to provide the transparency that they could.

He welcomed financial institutions' move towards more diversified boards, including more women and people from backgrounds ranging from physics to sociology. This could contribute to stability, as the CEOs of many of the failed institutions appeared to have had risky types of behaviour in common. He called for tougher sanctions on individuals in cases of severe mismanagement, including prison terms and industry bans.

Mats Isaksson, Head of Corporate Affairs at the OECD, a member of the WEF Advisory Board on Corporate Governance and Director of the Swedish Corporate Governance Forum**,** said that the term corporate governance is used in many different contexts. And in order to avoid confusion it is important to distinguish what aspects of corporate governance fall within the domain of public policy and what aspects should be left to market participants.

Very often, the corporate governance debate is focused on the investor dimension and shareholder rights. This is also essential. However, he said, the corporate governance framework must also make it attractive for growth companies to seek money from public equity markets. It should promote access to equity capital for entrepreneurs and "tomorrow's companies". This may imply that one set of corporate governance rules will not fit all types of companies. The structure of corporate governance may have to be quite different in a first generation tech company that still has the founder as a controlling owner compared to a mature corporation with totally dispersed ownership.

"Existing, as well as any proposals for new, corporate governance rules must always be assessed against the functioning of capital markets," he said. "And this was exactly what we did before we started the revision of the OECD Principles of Corporate Governance last year."

Taking a global view, we also see that the image of totally dispersed corporate ownership that has influenced much of the corporate governance discussion is challenged by reality. This is obviously true in many emerging markets. But also for many of the largest and most successful companies in advanced economies, including Google, Facebook and Berkshire Hathaway. In many ways, this presence of controlling owners automatically solves a lot of the traditional corporate governance problems with respect to electing the board and monitoring management.

Responding to the two speakers, **Larry Thompson,** Vice Chairman and General Counsel of the Depository Trust Clearing Company (DTCC), addressed Wright's point about trade repositories, and said that the G20 mandates on transparency from 2009 have been a failure. One reason is that the G20 mandates were largely implemented by local jurisdictions. These focused on their own marketplaces, with their own laws and local regulators, rather than on bringing transparency into the global marketplace. He proposed that trade groups work with prudential regulators to agree on a small data set that could be put together by all the trade repositories dealing with systemic risks.

Thompson said that the DTCC is a financial market infrastructure that is owned and governed by its users. It acts as a cooperative for the financial industry. Its clients are its users, who are also its directors, and its operations must therefore be transparent and understandable.

DTCC offers clients a wide range of educational resources related to risk management and mitigation, and promotes dialogue and collaboration for all users. The company can do this because, despite its commercial mindset, it can price its services flexibly, making it less subject to the cyclical revenue pressures experienced by owners and clients. As a result, it can focus on risk management and the mitigation of systemic risk, Thompson said.

Nicolas Véron, Senior Fellow of Bruegel and Visiting Fellow at the Peterson Institute for International Economics, in Washington, began his response by saying that not everything should be regulated. So EU authorities should think carefully about the size and scope of existing regulation.

He agreed with Wright that sanctions should be higher. Comparing the European Union with the U.S., there was a big gap in this respect until the financial crisis, which has only partly been filled since.

Véron said that transparency needs to be regulated, or else it won't happen. While financial institutions have an incentive to be transparent, because it can show their strengths, a reliance on market incentives will bring about only a low level of transparency. He said that the last two years have shown that results will only be produced with a strong enforcement framework for accounting and auditing.

Véron downplayed the prospects for changing the culture of the financial industry. Crises generally spark attempts to regulate culture, but these don't generally work, he said. Many Europeans have proposed regulating compensation as a proxy for culture, but fraud should be regulated as such and not via compensation, he said.

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