

## **A Financial Markets Policy for the next 5 years**

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**I**n surveying the priorities for the new European Commission in the area of financial markets policy, three themes stand out: moving back to normal in financial markets regulation, adequate implementation and enforcement, and access to finance. The times of crisis and stress are over, permitting rule-making to return to its normal pace and procedures and allowing for longer lead times, impact assessment and consultation. But the hangover from the past five years is huge, and public opinion on the role of the financial sector will continue to be critical for some time to come, which will impact the debate. This also implies that implementation and enforcement will need to be followed-up carefully, as any flaws could rapidly attract headlines. Access to finance should be the overarching theme, in all its dimensions. Access to credit for SMEs, access to capital markets for new ventures and access to finance for households. Tackling these matters, however, will not be straightforward.

### **What's the 'new normal' in financial markets?**

Most, if not all major pieces of legislation were adopted under the previous legislature. What remains to be handled came up late in the term and could not be finalised in time, such as the regulation of benchmarks and money market funds, and the structure of banking. Looking back, this means that an enormous regulatory workload was channelled through the European institutions over the past five years. But it also triggers a raft of questions for the next five years: How are financial markets adapting? What is the new normal in finance? And how should the institutions react to imperfections in the new regulatory framework?

The new normal should be a more sustainable banking, much less profitable on the one hand, but with higher levels of capital and buffers and resolvable, with clearly separable entities and burden-sharing by senior debt holders. But EU markets have fragmented considerably during the crisis, and cross-border services provision declined, resulting in less competition, especially in the smaller markets. The challenge is to start market integration moving again. Failure to do so risks a re-nationalisation of markets and missing out on the objective to break the vicious circle between banks and sovereigns?

A large part of OTC derivatives markets have moved rapidly to central clearing. Over 60% of the interest rate swaps, the largest part of the OTC derivatives, are now centrally cleared in

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central counterparties, but the total nominal value of derivatives contracts remains very high. It is now waiting for the implementation of EU legislation on central trading of bonds and derivative instruments, which should be in place by 2016 with MiFID II. This should bring about a much more competitive and transparent market for these instruments, in the same way as we have observed in equity markets over the last two decades.

## Banking union and more

Making it all work will be the priority for the coming years: implementation and enforcement is the keyword, not only for banks, but also for supervisors. With banking union, the EU should be in a position to radically improve its expertise in supervision, with strong multinational supervisory teams concentrated at the European Central Bank, applying the same reporting standards throughout the eurozone and beyond. But the reputational risk is high.

Important competences were left to the member states in e.g. setting bank-specific and macro-prudential buffers. The following years should indicate to what extent member states will exploit their competences. The European Commission and the ECB will need to be vigilant to act against excessive power grabbing.

With the creation of the Single Resolution Board in the Single Resolution Mechanism (SRM), the EU managed, against all expectations, to be awarded a new central competence, the coordination of the resolution plans and crisis management of large cross-border banks. This is a very challenging task and requires ready access to all information about these banks, and the capability and authority, if needed, to resolve a bank over the course of a single weekend. But it will also require close cooperation between the European Commission, the manager of the Single Resolution Board, the ECB and the member states.

As a result of the crisis, macro-prudential supervisors, data consolidators and trade repositories were established. Hence supervisors should have much more data available to them than before, but questions remain: Will these data be sufficiently comparable? Will they be consolidated? Will they be monitored? And will big hiccups be observed and acted upon?

## Access to finance

The main issue on the policy agenda of the post-crisis period is access to finance, in all its dimensions. Deleveraging, risk averseness and tighter regulation have created financing problems for SMEs and start-ups. Banks are under tighter monitoring, and the capital market hardly exists as an alternative source of funding for start-ups. This has led the new Commission President Juncker to call for a Capital Markets Union.

But what is a Capital Markets Union? It implies that the markets in which capital is provided by investors to entrepreneurs are not sufficiently unified in Europe. Or that the different actors needed to make capital markets function efficiently are not, or are very unevenly, present in Europe. Considering that harmonised regulation is now in place covering these different actors – banks, issuers, rating agents, auditors, investment funds, institutional investors, – the main issue seems not one for European policy-makers to regulate, but rather for the markets, or national and European authorities to enforce rules and ensure market access. We thus need a very subtle policy to stimulate capital markets in Europe.

Home ownership remains one of the key issues on political agendas of numerous EU member states. Yet, partly due to the continuous tightening of lending standards of housing loans, resulting from poor housing prospects, increasing balance sheet constraints and rising costs of

funds, owner-occupied rates (OORs) contracted in many countries, especially among the poorest households, for which dramatic decreases have been recorded in (OORs) since 2007. Within this context, have the EU rules been sufficiently harmonised to promote adequate access to housing finance? What will be the impact of the newly adopted Mortgage Credit Directive on this issue? Should reduced risk weightings for mortgage loans under CRD IV be monitored? Will action be required to harmonise credit information in the EU?

The overall tightening of lending standards of consumer loans, driven notably by the creditworthiness checks of consumers and the risk of the collateral demanded, has contributed to a significant decrease in the volume of new consumer loans. Consumer credit has traditionally been one of the main drivers of the growth of private consumption (whose cumulative contribution to real GDP in the euro area was +5.5% over the period 2001-07 and -0.7% between 2007 and 2013) and, as such, could play a significant role in the economic recovery of the EU.

As a result, the overall regulation of households' credit markets raises the key question: How should these policies be designed from a macroeconomic perspective?

### **Global regulatory coordination?**

A hallmark of the crisis response was the global regulatory coordination in the G-20 context. Some recent geopolitical tensions, as well as discussions about extraterritoriality of regulatory actions, have put strains on this process. It is of the greatest importance that this process can be continued in order to properly implement what has been agreed, such as Basel III, central clearing of OTC derivatives and global coordination of resolution plans. Two priorities stand out from a European perspective, given that it is home to 14 of the 29 globally active banks: standardising the validation and increasing the low levels of risk-weighted assets of the large European banks, and monitoring the global implementation of their resolution frameworks.