The future framework for capital markets in Europe
Summary of dinner discussion with John Berrigan, October 1st

1. The art of the possible

Like any EU project capital markets union is limited by political consensus and is a project of the possible. The industry should not confuse the incrementalism of capital markets union with a lack of ambition. The word ‘union’ is an indication of the ambitious nature of the project but the focus is more on the development of a single market for capital from the bottom up and less on the creation of new structures or institutions from the top down.

2. Step by step

Capital markets union is a continuum. While it may be a new name it is not a new concept: it is the logical continuation of the Financial Services Action Plan, and the idea of free movement of capital in Europe dates back to the 1957 Treaty of Rome. The financial crisis distracted the EU from closer integration but capital markets union is a long-term game. The action plan addresses the low hanging fruit (such as securitisation), medium term gains, and it begins to address longer-term issues, such as the first steps towards the harmonisation of tax and insolvency law.

3. Recalibration not rewriting

The review of the cumulative impact of post-crisis regulation is about recalibrating and tweaking regulation, not redrawing the entire regulatory framework. Even with the benefit of hindsight, most of the regulatory reform since the crisis would have been the same. Be careful of confusing intended and unintended consequences: higher capital and liquidity requirements were expected to have an impact on risk-taking and market-making. It is up to the industry to come up with better solutions – the more empirical and focused the better – rather than refighting old battles.

4. Making the case for capital markets: less developed markets

Capital markets union is a project for all 28 member states, but it cannot impose solutions on countries which have not yet embraced capital markets. It is important for the industry and for more developed markets to help make the case for how capital markets work and what the benefits could be to less market-orientated economies. At the same time, capital markets union needs to be flexible enough to incorporate smaller markets, and accommodate the cultural and historical reasons for the low level of development of capital markets in many economies.

5. Making the case for capital markets: the role of the UK

Capital markets union will fail if it is perceived as a conspiracy led by the City of London. The UK has an important role to play in showcasing the value and benefits of capital markets, and in sharing best practice and infrastructure with less-developed markets, but without imposing it upon them. The UK can play a big role in sharing the risk and cost of building bigger capital markets, but needs to be careful of giving the impression that it wants to hoover up business from smaller markets.

6. Making the case for capital markets: developed markets

There is some resistance towards capital markets union from some larger member states with big universal banks or a large insurance sector with little motivation to change. The question is not binary: it is about the potential benefits of reducing the over-reliance of much of the European economy on bank lending without undermining the very important role that banks can and should continue to play in financing growth. In the wake of QE and the low cost of bank lending, capital markets are not an easy proposition to sell right now, but as and when monetary policy normalises, capital markets should come into their own.

7. A difference in culture

Capital markets face significant cultural prejudice in many countries in Europe. For example, the Anglo-Saxon approach to building a company with a view to an exit is a world away from many small and medium-sized family-owned businesses across Europe that are perfectly happy without venture capital funding or issuing bonds or equity. Outsiders view the UK's firm belief in the virtues of capital markets to be just as defensive and self-interested as people in the UK view Germany's faith in its three pillar banking system or France's commitment to its insurance sector.

8. A new socio-economic order

In order to succeed in the long-term, capital markets union will require a fundamental socio-economic redesign. While Europeans save more than Americans, they invest far less and there is a significant trust deficit in the financial markets that pre-dates the financial crisis. Europe needs to have a proper debate about how countries and individuals plan to fund their future pensions liabilities. Even a gradual shift away from the conceit that governments will pick up the pensions bill tomorrow towards building longer-term pools of capital in Europe would have a significant impact on the development of capital markets.

9. Don't let a good crisis go to waste

While banking union and the creation of a single supervisory mechanism are good examples of what can be achieved in terms of harmonising supervisory and regulatory structures, they were motivated by the urgency of the crisis. If capital markets union is about jobs and growth, at what point will countries become desperate enough to tackle untouchable subjects such as breaking up the capital distribution models of the big insurers or protectionism for national and regional banks? Addressing the defensive approach of many countries – and improving the consistent application of existing rules - could have a big impact.

10. A long-term game

The debate about the value of capital markets needs to be had and it is winnable, but with several caveats. A focus on the benefits of 'patient capital' could be more persuasive than the benefits of capital markets to many sceptics of capital markets union. And the capital markets industry could also do a better job at demonstrating its commitment to patient capital by more closely aligning itself with customer outcomes and on rebuilding trust with policymakers and the wider public. Not least, capital markets in the rest of the world are not going to wait for Europe to gets its act together. This is the first chapter: the conversation is only just getting going.