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AMAFI POSITION PAPER

REFORMING EU-27 FINANCIAL MARKETS

The development of EU-27 deeper, autonomous and more integrated capital markets will be critical to ensure the Union can overcome the challenges it faces, such as **(i) the mitigation of climate change, (ii) the adaptation to the digital revolution and (iii) the ageing of its population**. Because of the extent and criticality of these challenges, it would be **unrealistic to believe that the financing of solutions can rely solely on bank loans**, and **unwise to try and delegate it to third country financial markets.**

With the UK, so far the main financial center of the Union, leaving the EU, **it is crucial to deepen and intensify the reflections around the future of the Capital Markets Union (CMU) initiative**. More than four years after CMU was launched, it is far from being completed, with only some legislations implemented to-date, and limited impact so far.

As a new European Parliament was recently elected and a new European Commission (EC) is due to officially take office on 1 November 2019, **AMAFI considers the next coming months should be used as an opportunity to take strong political decisions to enable EU-27 financial markets to play a more important role in the financing of European economies.**

Since the beginning of the CMU project, AMAFI has closely followed and contributed to discussions on the legislations proposed by the EC. In AMAFI / 19-46, we laid out the issues for which we consider reforms are needed for CMU 2.0 to deliver on the three main functions of financial markets.

In this paper, we highlight **(i) the reforms initiated at the end of 1970s/early 1980s which enabled the US financial system to transition from bank-based to market-based and (ii) a first set of targeted recommendations that we consider as instrumental to reform EU-27 capital markets.**

Later in the autumn, we will publish a report on the future of EU-27 financial markets that was mandated to the Center for European Policy Studies (CEPS) with the objective of making a full set of targeted recommendations to EU co-legislators.

1. The transition of the US financial system from bank-based to market-based model

The US financing ecosystem is often considered as the most accomplished example of market-based system. This has not always been the case. Back in the 1970s, the share of banks in the domestic financial sector's assets stood at 45%, close to its current level in the European Union (47%).

The shift from this bank-based model to the current market-based model began during the 1980s and unfolded over the next decades. An in-depth analysis shows that it was based on five main pillars:

(i) **a unified legal, regulatory, fiscal and, in some areas, infrastructure framework**. The depth of the T-bond market and the international role of the USD played a central role in that field;

(ii) **reforms that enabled the consolidation of banks** (allowing interstate banking, and removing barriers to cross state border mergers) **and the emergence of champions in the CIB area** (liberalization of the list of activities banks could engage in);

(iii) **a strong public involvement in selected domains** where private initiative would not be sufficient to ensure success (the Government Sponsored Enterprises in the securitization market, the Small Business Administration to guarantee the access of SMEs to bank loans);

(iv) **the depth of the securitization market** (55% of the United States GDP at the end of 2018, with a strong concentration on mortgage-based securities, that represent 80% of issuances), **enabling banks to free massive capacity from their balance sheets**;

(v) **the consistence of the pension funds ecosystem**, a significant contributor to the development of US financial markets, and a provider of long-term financing for companies and projects.

AMAFI is conscious that these factors could not be transposed as such in the EU-27 notably because it is not a federal state. Still, we consider **they are worth taking into account to help frame future EU reforms as the EU-27 financial system is in the same situation as the US one forty years ago.**

2. Proposed recommendations to reform EU-27 financial markets

At a time where Europe is renewing its leadership, AMAFI considers that with regards to financial markets regulatory reforms, **the only way to move forward is to take ambitious political decisions associated to a long-term vision** which should notably aim at making EU financial market actors stronger for CMU to deliver on its objectives. The proposed reforms will require time before one can beneficiate from concrete results and for some of them would require a step-by-step approach.

While there are obvious correlations between the proposed reforms below and what was implemented in the US, they also result from the work that has been undertaken together with the CEPS in preparation of the report.

Enabling the securitization market to take-off – The STS securitisation Regulation is far from producing the expected results. The future regime should require less prudential requirements, consider the creation of similar Government Sponsored Enterprises like in the US and limit divergences in member states bankruptcy laws.

Completing Banking Union (BU) – We consider it is essential to finalise the construction of the BU project by solving the home-host issue to enable the cross-border consolidation of EU banking sector. It is critical for the EU to have strong financial market actors which would be in a capacity to not only fulfil EU financial needs but also to compete with international actors.

Considering a targeted public support in specific areas – It would imply the necessity of a public risk sharing. Public involvement should be planned on the long-run and geared towards effectiveness from the viewpoint of the financing of the economy, rather than dictated by crisis situations.

Moving towards a unified and harmonised framework for financial markets across the Union – This notably means reinforcing the role and powers of pan-European supervisors in the domain of wholesale markets.

Establishing an ecosystem of pension funds – Such pension funds would complement pay-as-you-go systems and contribute to ensuring their performance despite the ageing of European societies, while channeling capital to long term and risky projects that require patient investors. While highly dependent on member states fiscal strategy, the creation of pension products with an advantageous tax treatment should be considered.

Creating a European Safe Asset – Such Safe Asset would act as a stabilization factor, notably by helping to reduce the sovereign-financial nexus, it would provide a deeply liquid source of high quality collateral to favor cross-border transactions and it would offer a risk reference and help to achieve a more efficient allocation of risk amongst the financial system. On top of playing the role of a back-bone to European integrated financial markets, a Euro-denominated safe asset would also serve the objective of fostering the international role of the Euro.

Ensuring that EU citizens receive an adequate financial education at an early stage – To ensure financial literacy (household budget, long term financing needs, operation of an enterprise, bonds and equity characteristics, funds, pension funds etc). In particular, we believe it is crucial to promote financial education across Europe in order to encourage citizens to invest into products that meet their long term objectives.

About AMAFI

Association française des marchés financiers (AMAFI) *is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.*