

Christian Noyer: Views on the Capital Markets Union project

Speech by Mr Christian Noyer, Governor of the Bank of France and Chairman of the Board of Directors of the Bank for International Settlements, at the Paris Europlace International Financial Forum, Paris, 9 July 2015.

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Ladies and Gentlemen,

It is my great pleasure to be here today at the Paris Europlace International Forum and I am particularly thrilled to exchange views on the Capital Markets Union project with one of its major architects, Olivier Guersent.

This project indeed echoes many concerns tackled at the Central bank level, in particular how to achieve a better balance in the funding structure of the economy, and improve access to funding for businesses, notably SMEs and infrastructures, while ensuring financial stability. Although this initiative was announced only a year ago, it has soon become topical with the public consultation launched in February by the European Commission.

The Banque de France was committed to answering this public consultation, which constitutes a milestone in the construction of a Capital Markets Union. Let me briefly share with you our vision.

I welcome and support the CMU initiative as a promising avenue for growth. However, I believe that three major pre-requisites have to be met in order to make it a successful endeavor: (i) a clearly defined framework focused on a limited set of operational deliverables, (ii) the right articulation between market-based financing and bank financing, (iii) the necessity to ensure financial stability in the long run.

(i) First, a Capital Markets Union should be structured along a clearly defined and articulated framework and focused on a limited set of operational deliverables.

As an overall priority, we believe that the initiative should seek to promote equity instead of debt financing for long-term financing. Equity financing is crucial for firms to grow and operate over the long run, all the more since we must pay attention to the high level of indebtedness in Europe with respect to both the public and private sectors, including SME borrowers. The current ratios of debt-to-income are indeed to be adjusted to a more sustainable path.

Notwithstanding this primary objective, debt instruments remain an indispensable funding tool. As far as operational deliverables are concerned, we share the view of the European Commission that the development of both Simple, Transparent and Standardized (STS) securitization and Private Placements is achievable in the short to medium run. 2

Securitization is indeed a useful tool to help fund the economy, as a means to free regulatory capital and to create liquid assets, particularly in the context of tightened capital requirements for banks. The CMU could for instance promote initiatives such as that carried out in France, where banks, with the support of the Banque de France, have taken steps to monetize their pools of credit claims. Banks now have the option of structuring these loans into marketable debt securities which are issued by a securitization vehicle (called Euro Secured Note Issuer or ESNI), in order to raise funds over the medium term.

Regarding private placements, market-led initiatives have already allowed the effective development of European common standards. The French financial industry has been particularly active in this field, with the development of a Charter for Euro Private Placement for France in 2014. This Charter has been re-used by the International Capital Market Association (ICMA) to elaborate a market guide on common market standards and best

practices. These initiatives could leverage on a common European definition and classification of SMEs to develop a Pan-European Private Placements market.

(ii) Second, market-based financing should be seen as a complement to, not as a substitute for, bank-based financing.

It is essential to foster the development of market-based financing as a complement to bank-based financing. Although this process has already started, the speed and extent of the shift differ across countries and sectors. Even though a rebalancing of the European economy financing mix is a desirable outcome as it diversifies the available sources of funding, banks will still have a major role to play.

Some segments of the economy, namely SMEs and infrastructures, heavily rely on bank-financing, due to the existence of high fixed costs and significant information asymmetries. Banks are indeed better equipped to assess the credit-worthiness of such counterparties or projects.

Having said that, clear and transparent information on credit risk is a prerequisite to the recourse to any source of funding, be it intermediated or not. The CMU action plan should cater for initiatives promoting private sector solutions, such as a broader use of existing rating tools.

Investors need also to access clear, comparable and comprehensive accounting reporting which are currently lacking for most SMEs in Europe. Because accounting rules are the basis of financial information, a Capital Markets Union cannot be effective with 28 different accounting systems. This is all the more relevant in the Banking Union, where banks supervised by the Single Supervisory Mechanism (SSM) are still subject to different accounting systems. In this area, progress is highly desirable and as a first step, I would support an initiative aiming to assess the quality and degree of comparability of national accounting standards and to promote further convergence.

(iii) Third, it remains necessary to ensure financial stability in the long run.

The shift towards more market-based financing would entail several implications from a financial stability perspective.

The development of alternative sources of funding, outside the banking system, brings a necessary diversification. Yet the risks associated with disintermediation are clear, notably a limited assessment

of risks by investors or less ability to address difficult situations and gaps in supervision. In parallel, re-intermediation by non-banks raises level-playing field questions linked with uneven regulation and supervision across sectors and countries.

The objectives of the Capital Markets Union should serve as a backbone to the regulatory efforts made at the European level. Before adopting new pieces of legislation, it is of utmost importance to thoroughly examine their impact. Even though the analysis of the cumulative impact and the interactions between regulations is still in its early days, vigilance is required to ensure that the implementation of reforms does not result in a reduction of financial activities, such as market making that are vital for preserving market liquidity, financing investments and firms and ultimately the real economy.

The foreseen banking structures reform and European Financial Transactions Tax (EFTT) are cases in point. In both projects, an appropriate approach should strike the right balance between limiting risks associated with trading activities and the need to preserve financial activities that are useful if not essential to the development of the real economy. Doing so would be fully compliant with the overarching objectives of the Capital Markets Union.

Having better integrated markets within the European Union (EU) would also mean the emergence of more reciprocity issues as regards macroprudential policies. At the macro level, authorities should then closely review the potential additional vulnerabilities and risks attached to the CMU both at the domestic level and on a cross-border basis. Authorities will also have to strengthen their analytical framework and possibly complement their macroprudential instruments which are mainly bank-based at the current juncture.

I will conclude with some remarks regarding longer term work, namely how to harmonize further domestic legal regimes and the institutional architecture.

The Commission's green paper has identified some areas for longer term work, including the need for further harmonization of insolvency regimes, securities laws and tax regimes. Achieving such goals would imply a very complex and politically sensitive process. This is why, as a first and more realistic step, we suggest starting by a stock-taking exercise whereby investors would have a clearer view of divergences and potential discrepancies between the various EU legislations. It is also worth noting that in the field of financial market infrastructures, Eurosystem initiatives have turned out to be powerful catalysts for harmonization. For instance, significant progress has been made in the standardization of corporate actions through the Target2-Securities project without having to adjust the respective legal frameworks.

Finally, and I know this is a topic where Olivier will be happy to pick up, more regulatory convergence can be achieved without changing the current institutional architecture but via increased cooperation between European Supervisory Authorities (ESAs) and national authorities.

I thank you for your attention.