John Hurley: Capital markets and financial integration in Europe

Opening remarks by Mr John Hurley, Governor of the Central Bank and Financial Services Authority of Ireland, at the Ninth Conference of the ECB-CFS Research Network on Asset Management, Private Equity Firms and International Capital Flows: Their Role for Financial Integration and Efficiency, Dublin, 8-9 October 2007.

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Ladies and Gentlemen, good morning and you are all very welcome to this ninth conference of the European Central Bank and the Centre for Financial Studies research network on Capital Markets and Financial Integration in Europe. We are delighted in the Central Bank and Financial Services Authority of Ireland to be hosting this event in Dublin and I would like to particularly welcome those of you who are visiting us here for the first time. I would also like congratulate the organisers on having the foresight to choose, as long ago as last year, a topic for this conference which would prove so timely and interesting in the current environment!

The conference programme is notable for both its diversity and its topicality. This is a testament to the work of the ECB-CFS research network and represents a successful collaboration on research in the area of financial market integration and international linkages. The Centre for Financial Studies conducts and facilitates excellent independent and internationally-oriented research on financial markets, financial intermediaries and monetary economics, and the promotion of dialogue between academia and the financial community. It is a natural partner to collaborate with the ECB in sponsoring this research network. The ECB has, since its inception, maintained a focus on encouraging research which is directly relevant to understanding the workings of the global economy. The ECB has a strong track record of interacting with both academics and market participants in this regard.

In the five-and-a-half years since its inception, the ECB-CFS research network collaboration has resulted in nine conferences, including today's. These have consistently been composed of top-quality research, covering a myriad of topics in the area of the structure and integration of financial systems in Europe and its international linkages. I was impressed to see that, as far back as 2004, the network was exhibiting its talent for foresight, which I have already mentioned, in investigating a number of issues on bank contagion in Europe, interbank exposures, liquidity and systemic risk. And as far back at 2003, when the issue was still low on the financial markets radar, the network was examining private equity issues. Also, and more intriguingly, it looked at "heatwaves and meteor showers" - something we were in short supply of here over the past summer.

Back to the present, I am delighted that the Central Bank and Financial Services Authority of Ireland has been involved in the development, organisation and hosting of this latest conference. I know that we have benefited significantly from collaborating with the ECB and CFS in this field and I look forward to further developing these links in the future.

All three organisers certainly set themselves a significant task when they undertook to "co-ordinate and stimulate top-level and policy-relevant research that significantly contributes to our understanding of financial system structures and integration". From the programme for this event, however, I can see that you have certainly provided plenty of material to stimulate debate and consider policy implications on issues related to asset management, private equity firms and international capital flows.

There has, of course, been a considerable amount of innovation recently in the private equity and hedge funds industries, and in complex financial instruments and asset management strategies generally. These innovations serve to more fully complete the financial markets landscape, although when used imprudently can present extra risks, as evident in recent market developments. This innovation has been led, to a significant degree, by market participants and has presented a number of challenges for policymakers, especially regarding the implications of risk transfer developments, valuation strategies and market disclosure rules for financial stability and the efficacy of policy. There is much that central bankers and academics can learn from market participants in these areas and a collaboration such as this research network provides an excellent forum for a sharing of ideas and an opportunity to contribute to these debates.

Turning to just a couple of the issues for discussion at this conference, the performance of, and risk and disclosure practices in, the hedge fund industry were of course a major focus of attention earlier this year, but have been pushed out of the headlines somewhat in recent months. However, I am sure that they will return - albeit hopefully not in an environment of disruptive market conditions. We can expect a renewed focus on the risks, which hedge funds can pose for highly-exposed counterparties and for markets generally, and on the type and extent of policy responses that can realistically be taken to help alleviate some of these risks. Earlier in the year, market disclosure issues and questions about the adequacy of the indirect model of regulation - where the focus was on the exposures of counterparties, especially banks, to hedge fund risks - was a major focus of the debate about possible policy responses. There are very differing views about both the effectiveness of further disclosure measures and the moral hazard risks associated with increased disclosure. I very much welcome the contribution which this conference is making to the debate, with both a full session and of course the keynote address devoted to hedge fund issues, including the disclosure issue.

With regard to private equity deals and leveraged buyouts, even though recent market events appear to have halted the dramatic rise in deals, when normal market conditions are restored one wouldn't prejudge a return to the previous high level of activity. A major concern for central bankers and financial regulators in this area is whether the growth in these deals has been accompanied by any significant increase in credit risk for entities, such as banks, which are providing significant leverage to private equity deals and funds. While research, published by the ECB, suggested that large banks' exposures in this area are manageable relative to their capital buffers, there is also the issue of "warehousing risk", whereby the movement of these risk exposures away from banks and into markets are contingent on liquidity in credit risk transfer markets and on the effectiveness of risk syndication processes. Clearly, the area of private equity is one where we need a greater degree of analysis to inform our judgment about the financial stability issues arising, and I am very pleased to see that you have quite a significant degree of empirical research being presented here on an extensive range of issues in the private equity arena.

With so much interesting research to be presented and debated, I don't propose to take up any more of your time this morning. To the organisers, I congratulate you on your efforts on bringing this collaborative event together and I wish you every success with the conference. I look forward to hearing the full conclusions of your deliberations, and especially to reflect on the policy messages.

Many thanks for your attention.