Danuta Hübner
Member of the Committee on Economic and Monetary Affairs, European Parliament

"Top priorities for the next Commission on Capital Markets Union"

Keynote speech at European Capital Markets Institute Annual Conference Dinner

9 October 2018, Maison Ducale, Brussels

I think it is a perfect moment to take stock on where the European Union is regarding the construction of the Capital Market Union. I would not like to go back to the history of the CMU but it is worth reminding here what were the main objectives that led back in September 2015 to launching the CMU action plan. I think there were three of them.
The CMU project was supposed to diversify and increase funding available to EU companies. It was also seen as a vehicle to increase private risk-sharing and, last but not least, to foster financial integration within the Union and the single market.

The first goal was to diversify the funding available to companies away from banking. This did not mean undermining banking finance or creating competitors to banks but meant helping alternative sources of financing to develop so that more funds overall were available to SMEs and start-ups. Being more diversified, the financial system would be less vulnerable to shocks originating within the banking system. There is a natural complementarity between bank and non-bank funding. For instance, venture capital funds and crowdfunding providers are able to reach out to companies which would not be able to obtain financing from banks.
Regarding the second aim - fostering private risk-sharing, as a complement to the public risk-sharing mechanisms - we were, and still are today, discussing it as part of the Banking Union and as part of the EMU reform. More interconnected markets allow to spread the risk across different countries and make the overall system, at the level of the Banking Union or of the Union as a whole, more resilient to asymmetric shocks.
Finally, I believe that the CMU should be perceived as a pro-integration project. Two weeks ago, I heard an economist from the Commission, Diego Valiente, explain that the CMU was a formidable integration tool because you do not need to share a currency to engage in CMU. This is an important dimension of CMU. It may help integrate euro and non-euro EU Member States and help Central and Eastern European economies, whose capital markets are less developed, catch up.

Where are we now with the CMU project ?

There have been some concrete improvements on capital markets. There was two weeks ago a very interesting presentation of a report by AFME which intended to define indicators to measure the progress of CMU. The main findings were that there was, maybe limited, progress made between 2012 and 2017 on some key points of relevance for the CMU objectives. For instance, financial integration within the EU has started to increase again, although it is not yet back to pre-crisis levels. More savings are invested in financial instruments. The depth of capital markets has been

increasing in Central and Eastern Europe. The EU is a leader in sustainable finance. The availability of risk capital for non-listed companies (that is, financing from venture capital funds and alternative funds for start-ups and non-listed companies) has doubled since 2012, albeit starting from a very low level.
So, there are improvements, but there is both good and not so good news. Some of the main weaknesses identified three years ago remain. For instance, the EU financial system remains heavily reliant on banks: in 2017, 86% of new funding for non-financial companies come from banks.

There have been legislative developments in the area of CMU. In the framework of its action plan, the Commission has overall been rather active in proposing legislation. It is also true that the legislative work has been proceeding slowly. Actually, only three pieces of legislation proposed in the context of CMU have been completed and have entered into force so far. I think here of the review of the prospectus directive, the review of the EU venture capital funds regulation and of the package on simple, transparent and standardised securitisation. Trilogues are to start on a fourth piece of legislation, the Pan European Personal Pension Product.

However, if there have been relatively few pieces of CMU-related legislation agreed so far, this is largely due to the fact that the activity of the Commission has been very recent, with many proposals which been issued only by last spring. They are now being under discussion by the co-legislators, the main ones being:
- the proposal for a regulation on crowdfunding services providers
- the package aimed to facilitate the cross-border distribution of investment funds
- the proposal for a regulation promoting the use of SME growth markets - the package of proposals establishing a European framework for covered bonds
- the package of proposals on sustainable finance, including the proposal dealing with the disclosures of sustainable investments and the proposal on low-carbon benchmarks.

Finally, the review of the ESAs, which is an older proposal, is still under discussion by the co-legislators and, as we meet here, the European Parliament is working on compromises on that file.

So, the first thing we would need to do is to complete the work on those files, which is likely to take us well into the respective terms of the next Parliament and of the next Commission. We must bear in mind that the last Econ meeting in this legislature will take place on 21 March next year and the last plenary vote on the 18 of April. Indeed, there is not much time. And the functional capacity of the future EP remains a big unknown.

I know that the current Commission considers PEPP as very important and hopes that it will prove itself a useful integration tool. But I would like to stress the importance of another dossier, which is the review of the ESAs. The importance of the ESAs will grow if, as we intend, our capital markets in continental Europe develop. So, looking further ahead to the priorities of the next Commission, reforming and strengthening the ESAs should be on the agenda in order to avoid market fragmentation and supervisory race to the bottom after Brexit. When we no longer have London but a greater variety of regional financial hubs such as Dublin,

Amsterdam, Paris and Frankfurt, we will need to pay even more attention than today to supervisory convergence.
In this situation, there is no really effective alternative to strengthening the ESAs. Supervisory colleges, where they exist, for instance in the area of CCP supervision, can do a lot to ensure convergence among their members. However, different colleges can have different approaches to identical issues and there is therefore a need for some kind of central coordination above their level.
Guidelines issued by the ESAs are very useful convergence tools, but they remain non-binding. There is no way for the ESAs to ensure they are applied in a consistent way by all national competent authorities across the Union. This is of course particularly the case on matters that require a lot of judgement from national competent authorities, such as the authorisation of firms.
Supervisory convergence is needed, but it should be understood as closer cooperation among NCAs and between NCAs and their respective ESAs. It does not mean that NCAs, where the expertise lies and which bear the ultimate liability for the decisions they take, will have to be stripped of their powers or will have to submit to a “supervisor of supervisors”. It is all about cooperation, consistency and finding the right balance between the different levels of governance.

I know the review of the ESAs is creating concerns among some Member States, but I am confident a way of addressing them will be found so that we can have a sensible agreement on that file.

Let me turn now to some issues that the current Commission has started to address but which will remain on our agenda and on which further work will be needed. One is definitely sustainable finance, for which there is a strong momentum. The Commission issued in March an action plan on sustainable finance that puts the EU ahead of many regions in the world and received praises, and has subsequently issued a package of three proposals. It is also a pleasure to see the strong interest of the industry in the issue of sustainable finance.
We need to use that momentum and keep up the good work in this area. The interest in that issue is lower in the US, so there is a real opportunity for the EU to become a global leader in that field. For this to happen we first need to reach agreement on the package of three proposals issued by the Commission in May. I also know that, further ahead, the Commission will continue its work with the help of its expert group on sustainable finance. At the beginning of the term of the next Commission, work should in particular be extended to the issue of social sustainability, and not only environmental sustainability.

We also need to keep a watchful eye on the development of Fintechs. The proposal on crowdfunding services providers is already intending to harness the potential of one technology considered to be part of the Fintech universe, which is crowdfunding. Developments in the area of Fintechs are fast, attract a lot of attention and interest, and some can be potentially very disruptive, for instance instant payments or distributed ledger technology. We therefore need to monitor closely what happens there and consider proper regulation at the right time: not too early not to stifle innovation, but also not too late so that we can intervene before problems set in or before diverging regulatory approaches are adopted.

I would also say a few words concerning the reform and harmonisation of insolvency legislation. Harmonisation of insolvency laws is absolutely crucial in order to remove barriers to cross-border investment and accompany the setting-up of the single bank resolution regime in the euro area. Each time Elke Koenig comes to address the ECON committee, one of her major pleas is for further harmonisation of insolvency legislation in order to make the work of her teams easier and more effective. In some countries, independently from the challenge of harmonisation, more effective national insolvency legislation is also needed to address the challenge of non-performing loans. The relevant Member States are working on this issue.
Harmonising insolvency legislation will be one of the toughest battles to fight because it touches on property law and on national preferences, but it is an issue we cannot avoid. Some work has been done by the current Commission, with a proposal for a directive on second chance and preventing restructuring framework, and it should be continued and deepened by the next Commission.

As we speak, a big elephant in the room is Brexit, with its related cliff-edge risks, need for adaptation and risks of fragmentation.

The current Commission will have to do its utmost to secure a Brexit deal. The task of the next Commission will be to, based on the political declaration that will be annexed to the withdrawal agreement, actually build the future relationship between the EU and the UK.
This is what the 21-month transition period that should be set out in the withdrawal agreement is for. If we do not have a deal by the end of this week, cliff edge risks by end of March next year will grow.
In the field of financial services, we already know how the transition period will be used. Under all relevant pieces of EU legislation, recent ones and less recent ones, there will be a need for the UK to apply for equivalence to the European Commission and then, once equivalence is granted, there will be a need for UK firms to apply to EU supervisors for recognition. This will have to be done over the transition period and this will be a heavy task for the parties involved on both sides of the Channel. The transition period will also need to be used by the Commission to complete its check of existing third country provisions and see whether there is really no piece of legislation where a third country regime would be missing. It seems that for the moment it is not the case and that even the UK side has not identified specific texts where it would be necessary to add a third country regime.

So, Brexit will keep us busy well into the next Commission. I trust we will spare no efforts to start negotiating the future relationship deal with UK on the 1 April next year.

It creates risks that have to be addressed. Of course, the most disruptive situation would be a no-deal scenario.
From the work done by the Commission, the ECB and the Bank of England, it seems that, broadly speaking, there are three main areas of risks relating to Brexit.

The first is this of access to clearing. UK CCPs will stop being authorised in the EU at the time the UK ceases to be a Member State. They will be third country CCPs and have to seek recognition under article 25 of EMIR in order to be allowed to keep providing clearing services in the Union.

Also, under EMIR, OTC derivative contracts that are subject to the clearing obligation shall be cleared in a CCP authorised or recognised under EMIR. Therefore, EU clients and members will no longer be able to use UK CCPs to fulfil the clearing obligation as long as they are no longer authorised and not yet recognised in the Union.
However, there will be no obligation for UK CCPs to off-board EU clients and members: those will still be able to retain accounts at UK CCPs.

The second issue is the continuity of those contracts which have been concluded between UK and EU27 market participants before Brexit and expire after the Brexit date. This issue concerns two main types of contracts: insurance contracts and Over The Counter (OTC) derivatives.

The third main area of risk relates to data transfers. This includes both data flows between firms and the access of supervisors such as ESMA to data provided by UK firms.

There are also issues relevant to specific Member States. For example, the third country regime in the Settlement Finality Directive is actually a national option, not used by all Member States. This might create issue for the access to UK payment systems of firms located in those Member States not having a third country regime for payment systems.
Another example could be Ireland having no Central Security Depository (CSD) and currently using Euroclear, the UK CSD. This CSD will no longer be authorised in the EU after Brexit and therefore no longer authorised to offer services in the Union until its seeks recognition as a third country CSD. A solution to this issue will need to be found and reflection is ongoing.

There are disparities among regulators and between regulators and the industry as regards the assessment of exact magnitude of the cliff-edge risks. There are also discussions as to what issues are matter for firms to solve by themselves and what needs regulatory intervention.
What is certain for the moment is that preparedness work by firms is absolutely crucial as the extent to which cliff-edge risks will materialise will depend on the preparedness of firms. Neither the Commission nor member states can substitute for firms' contingency planning. What is also certain is that there is a need for political guidance from institutions, supervisors and regulators. Certainty, however, can come only with legal texts. Work on planning for Brexit and adapting to it has to continue and the effort will have to be sustained well beyond the Brexit date, into the transition period and possibly after.

The UK side is busy with Brexit preparedness as well, and with deciding on the way it will treat EU firms. In August this year, the UK government had committed to introduce a Temporary Permissions Regime (TPR) that will allow EEA firms currently passporting into the UK to continue operating in the UK for up to three years after exit, leaving time for their application for authorisation to be processed by UK regulators. The government has published the draft legislation that will deliver the TPR and the financial regulators, the Financial Conduct Authority (FCA) has published its approach to implementing this legislation and the Prudential Regulation Authority (PRA) has also set out its expectations for the this regime. Similar

temporary regimes will be provided for EEA electronic money and payment institutions, registered account information service providers, and EEA funds that are marketed into the UK.
The UK government has also committed to legislation alongside this, if necessary, to ensure that contractual obligations (such as under insurance contracts) between EEA firms and UK-based customers that are not covered by the temporary permissions regime can continue to be met.
The government has also laid draft secondary legislation that will establish a temporary recognition regime (TRR) for central counterparties (CCPs). This regime will allow non-UK CCPs to continue to provide clearing services to UK firms for a period of up to three years while those CCPs apply for recognition in the UK. The Bank of England has published further details on the approach to recognising non-UK CCPs.
The British government will also be bringing forward legislation to deliver transitional arrangements for: Central Securities Depositories, Credit Rating Agencies, Trade Repositories, Data Reporting Service Providers, Systems currently under the Settlement Finality Directive and Depositaries for authorised funds.

On the EU side we are awaiting announcement of potential no deal related contingency measures, however, I would not expect them before the end of negotiations.

Brexit will definitely, whatever the shape of the final agreement, result in a loss of integration with the UK, the largest and most developed capital market we have in the region. Continental Europe will have to adapt to it, and this largely implies deepening capital markets and improving their integration, which means that the CMU project is becoming all the more important after Brexit.

The other challenge or risk is this of trade fragmentation, which will result from Brexit but is also a threat at the global level. Of course, trade integration drives financial integration, so both are highly related. I know the Commission monitors trade integration and considers trade fragmentation to be one of the main risks over the next decade, also for financial markets.

So, you can see that there is a lot to address and to work on and I trust the next Commission will be up to those many challenges.
And since we are discussing capital markets Union, I would wish to conclude with a last remark for the current and next Commission, which is that legislation cannot do everything. For CMU to succeed, we need a cultural change, concerning for instance the approach to risk, the approach to investment and the approach to entrepreneurship. This is long-term work, which requires involvement from banks, exchanges, corporates, financial advisers and other actors. It is crucial if we want to reach the benefits of the CMU.
There is actually no trade off between keeping close links with UK to continue benefitting from this large and complex capital market around the corner and developing our own capital market through various CMU initiatives . We need both and we should work parallel to benefit from both. But the time is coming to look anew at the action plan and make it better fit the challenges.