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Capital Markets and European Competitiveness

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Introduction

Ladies and Gentlemen,

Let me begin by thanking the European Financial Forum for its invitation today. Events like this are indispensable. We need wide debate. Openness. Transparency. And good research and facts.

Global markets developments

Financial Services Markets are strong, growing in every segment, in every continent, powered by solid and unprecedented global growth. And Europe is at the forefront on hedge funds, in international banking, in insurance, derivatives and global IPOs.

Financial innovation is blossoming, making the financial system more efficient: credit derivatives better spreading the risks, exchange traded funds lowering management cost, real estate instruments giving new hedging tools and investment opportunities, structured products protecting returns. The list is long and growing everyday.

The global scene is also changing:

First, the US is questioning its own financial market competitiveness. Despite global growth, New-York is losing market shares on IPO, on hedge-funds, not only to "old" London but also to Hong-Kong and other emerging financial centres. Numerous reports have explored these issues: the legal and supervisory framework; class actions; regulatory structures; etc. I think some of these reports are excessively pessimistic – but it is true today that there is an alternative to the US capital markets – with the EU in the forefront.

Second, China. The ICBC flotation. The largest flotation ever. The clear evidence that Chinese financial services industry is no more a case study for IMF experts. And after the new banking law, all foreign banks are queuing for retail licences in China. Opportunities should abound, but financial services will no longer be sheltered from global competition. It is why we are striving for a level playing field and why China has become one of my top priorities during the second half of my mandate.

To cope with global competition, new ideas have arisen. For example, transatlantic stock-exchange mergers. The debate, launched in the G7, is now on a transatlantic free trade securities area based on mutual recognition. We welcome this. But also realize it will be difficult and complex. We need strong and competitive capital markets on both side of the Atlantic.

Regulatory issues and location decision

In today's global competition, location decisions are important. Thanks to plummeting transport costs, widespread internet access and global markets liberalisation, companies are freer than ever to choose where to establish. And the focus is more and more on "soft" criteria: the quality of the regulatory framework, flexible labour laws, tax issues, international standards in corporate governance. And the goal is not only to attract companies but people. More than ever, high skilled individuals are shopping around to find the best business and life environment.

We must capitalize on the tremendous work already done in financial services. Making the EU a better place for Financial Services is not enough; we must strive to be the best. I want an attractive, open and competitive Europe – being the laboratory for global markets.

For an attractive Europe, we designed our better regulation policy: open consultation, bottom up approach, economic impact analysis, calibrated regulation to stimulate market forces and competition, early participation of market professionals and national regulators, using all the flexibility provided by the Lamfalussy approach. And it doesn't stop there. We need constant evaluation of our rules… to make sure they remain fit for purpose. One strength of our system is that there are many checks and balances. They may slow us up occasionally – but it is the best method.

For an attractive Europe, we have adopted best of breed international standards: IFRS, Basel II and soon Solvency II which are principles-based regulations. We are determined to remove obstacles to cross-border business and clamp down on anticompetitive practices.

I call on you to help Nellie Kroes to excavate hidden practices, supply her with hard evidences of Member States protectionism.

For an attractive Europe, we also need more supervisory convergence. To give our companies a safe, competitive and cost efficient framework. Our approach is bottom-up, focusing on practices, capitalizing on the existing Lamfalussy committees, chasing out multiple reporting and alleviating unnecessary burden. To build both a more robust and more competitive supervision.

And our efforts are beginning to pay: carefully crafted pieces of EU legislation are becoming global yardsticks. For example, UCITS compliant funds are the global gold standard.

Private equity and hedge funds

A few words now on the development of hedge funds and private equity funds in Europe.

Hedge funds are now major actors. Global assets under management have grown by 450% since 1999 and now amount to $1.6 trillion. However, this is only 4% of total world GDP. The EU has been at the front line of this development. European domiciled hedge fund managers control €325 billion of assets.

There is a common misconception: that hedge funds are not regulated. That is not true. European hedge fund managers are subject to authorisation and supervisory requirements in all EU member States.

Many Member States have also introduced national regulations governing the constitution and organisation of hedge funds established on their territories. Furthermore, these national arrangements are complemented by regulations relating to the banks lending and trading with hedge funds. The sale, marketing and distribution of hedge funds to retail investors is also heavily policed and will be subject to stringent, harmonised requirements following the entry into force of MiFID.

I strongly believe that hedge funds are making a very positive contribution to the financial system. They provide market liquidity, enhance price discovery, and offer a vehicle for portfolio diversification.

Now to private equity. Private equity funds provide venture capital to help develop new businesses and to fund innovative companies. An important tool to transform research results into commercial opportunities. However venture capital markets in Europe are still underdeveloped.

As policy makers, we must do all we can to help this market work better – particularly early stage finance.

Private equity managers that specialise in buyouts provide important sources of alternative financing to European businesses. To improve and to transform existing companies. With a view to making them more competitive and more valuable. Most private equity investments still involve relatively small amounts of capital and small or medium sized companies. Over the last few years the scope and reach of the private equity funds has matured. The largest ones have started to invest in public companies. And to restructure some of Europe's larger private businesses.

Some say hedge funds and private equity pose some risks to financial stability or to established corporate governance models. I can hear calls for regulation as a response to potential risks that both the hedge funds and private equity markets may pose to the financial system. It is right that their rapid growth has attracted greater scrutiny.

However, I clearly do not see the need for any new specific European legislation. We have in place powerful regulatory safeguards and risk-mitigation measures. Including the monitoring of counterparty exposures. And the requirement for banks to maintain adequate capital buffers. We need to ensure that these safeguards are effectively implemented.

That risk management systems are robust.

This does not mean that we should be complacent. We need to remain vigilant. The development of hedge funds and private equity funds must be consistent with sound functioning of markets. However, there is no obvious regulatory gap. We have strong national and EU rules: Capital Requirements, Market Abuse, Transparency, MiFID, etc.

We should not get hung up on the slogan of more transparency. Appropriate transparency may play a role in encouraging market discipline and identifying vulnerabilities. But such measures need to be carefully specified. Ill-prepared initiatives will do little to reduce overall risk in the system.

Instead, the focus should be on further examination and analysis of developments, and firm enforcement of existing rules on market integrity and stability. In this regard, considerable efforts are currently underway at international level and within Europe.

Let me turn to the topic of the regulation of exchanges and capital markets.

The regulation of exchanges and capital markets

It goes without saying that we are on the threshold of major changes to the way European capital markets operate. I am referring, of course, to the forthcoming MiFID – the Markets in Financial Instruments Directive – which promises to ramp-up competition dramatically between different types of execution venue and across borders.

However large the effects of MiFID will be, it will not be a single ‘big bang’ event. MiFID will put in place a changed, more competitive game. The market structure will continue to evolve post-MiFID.

And besides, it is already having major impacts. We are already seeing some remarkable market innovation pre-MIFID lift off. In a little over 6 months we have seen major announcements of new platforms from Project Turquoise, Project Boat and others. We have seen price cuts and service upgrades from the incumbent exchanges in anticipation of increased competition. Software houses are offering firms the tools they need to comply. All of these market developments we welcome.

Of course, MiFID still requires a big implementation effort from firms, from Member States and from regulators. We have been publishing on our website the latest state of play of MiFID transposition. It is not satisfactory. The majority of Member States will be late in transposing. It will leave firms with only a short time to finalise their implementation efforts. I have written to finance ministers to impress on them the urgency of the situation. And we are taking infringement action against all Member States who are late.

Let's now come to the recent merger of NYSE with Euronext. My main message has always been the same: it is for markets and shareholders, and not politicians and bureaucrats, to make decisions about particular tie-ups - assuming regulatory and competition law aspects can be appropriately dealt with. In my view, a protectionist reaction to the merger, to create some sort of ‘European champion’ is dark age thinking. But European capital markets must be subject to European laws and European regulators.

While the immediate regulatory implications of such a merger have been relatively straightforward to cope with, clearly over time there will be pressure for greater integration of the various operations. Something like a transatlantic liquidity pool may be in the offing. In order to get there, we would need to face difficult questions of mutual recognition of regulatory regimes, and reliance on regulation by foreign regulators of particular aspects.

Turning briefly to bond markets, we are currently preparing a report on market transparency in the bond markets. Not for the pleasure of writing, but because we have been asked to look at this topic by the Parliament and the Council.

We took soundings last year and have asked two groups, the CESR and our European Securities Markets Expert, to advise us. We have asked them to focus on the question of whether there is a market failure with regards to transparency. Most market participants have said broadly that there are no significant problems, at least in the wholesale markets. But we must listen to all stakeholders, including very importantly retail investors, as well of course as taking into account the views of regulators, the Member States and Parliamentarians. Whatever happens there is a case for the industry to raise its own standards of accessibility to pricing information. We aim to hold a public hearing in September of this year, and to finalise our report early 2008.

Conclusions

Let me conclude: Financial Service Europe is on the right track. Competitive, innovative, in the lead, grasping new opportunities, confidently promoting its regulations, seizing new markets.

With hard work and close cooperation between regulators and industry, we shall remain on this track.