ETUC position on the Capital Markets Union

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Background

The Capital Markets Union Action Plan sets out a programme of 33 actions and related measures which aim to establish the building blocks for an integrated capital market in the European Union by 2019. By enhancing private risk-sharing, it intends to strengthen the European financial system by providing alternative sources of financing and increasing options for retail and institutional investors with a view to increasing investment.

The European Council of 28 June 2016 called for swift progress to ensure easier access to financing for businesses and to support investment in the real economy by moving forward with the Capital Markets Union agenda. On 14 September 2016, the European Commission called for the rapid completion of the first measures proposed under the Action Plan, especially the Simple, Transparent and Standardised (STS) securitisation package. The Council has already reached an agreement on securitisation and discussions are now being held at the European Parliament.

The Capital Markets Union initiative is built on the assumption that private businesses, especially SMEs, experience difficulties in gaining access to funding, and that the financing of private investment relies too much on bank lending and not enough on capital markets across Europe. By allowing better access to financial capital markets and providing different kinds of financing, the CMU is intended to be a tool for growth, job creation and financial stability.

The Capital Markets Union project should also be a way to strengthen the European integration process and make capital markets more efficient. However, notable differences exist between Member States such as bankruptcy rules or the definition of SMEs which could prevent a Europeanisation of Capital markets.

It is also questionable whether the lack of credit is the main impediment to growth and job creation. In addition, the ETUC points out that securitisation processes in the financial industry, while allowing risk-sharing between stakeholders, constitute a fast track to systemic risk propagation.

The relaunch of the securitisation technique is paradoxical given that policymakers implemented macro-prudential banking regulations, such as leverage ratio, after the crisis (Basel III and CRD IV), which the new package (through securitisation) will allow to be circumvented. Risks will therefore be transferred to the unregulated financial industry, the shadow banking system, which was at the heart of the spread of the financial crisis.

In this respect, the ETUC has concerns about the Capital Markets Union both as a means of increasing growth and job creation, and as a stabilising tool.

Europe needs to increase domestic demand

It is now recognised by European institutions that lack of domestic demand, *i.e.*, consumption, public and private investment, is the main economic issue being faced by the European Union. It is therefore important for Europe to increase investment. However, enterprises can invest only if they can expect a demand for their products, and this remains the most important issue. In the latest Survey on the Access to Finance of Enterprises in the euro area by the European Central Bank, published in March 2016: "'Access to finance' was considered the least important concern for euro area SMEs while 'Finding customers' remained the dominant concern". 'Access to finance' was even less of an issue for large firms. In addition, the survey found that SMEs confirm "an increase in the availability of bank financing (loans and bank overdrafts) and in the willingness of banks to provide credit at lower interest rates". Indeed, the monetary policy implemented should have implied a huge increase in lending, which did not happen because of a lack of demand for loans.

Such results should persuade policymakers to reshape their policy recommendations for supporting a modest and very fragile recovery. The ETUC is therefore calling for an increase in public investment and wages as effective triggers for a sound and sustainable recovery.

The ETUC consequently questions the benefits of the CMU Action Plan in terms of growth and job creation, and expresses concerns regarding its impact on employment within the banking sector.

Financial stability

It should be recalled that the 2007-2008 crisis had its roots in the securitisation process in the mortgage industry in the US and rapidly contaminated the whole world of financial markets and banking, and therefore the real economy.

Indeed, lenders were not interested in borrowers' creditworthiness but mainly in the fact that financial assets (especially loans) could be easily tranched by categories of risk and repackaged as new assets to be sold, generating immediate fees and very large short-term profits. Such a technique allowed the dissemination of very risky financial products within the unregulated shadow banking system, giving rise to a very fragile and unsustainable financial environment. This is the originate-to-distribute model, which allowed the spread of the financial crisis, as opposed to the originate-to-hold model. Such a system, beyond its complexity, created a lot of opacity and moral hazard (because the bank originating the asset had no incentive to honestly disclose its information regarding the trustworthiness and risk level of the borrower), and was driven by a blind faith in deregulated financial markets as an efficient capital allocation intermediary. Financial institutions are now required to retain 5% of each securitised asset in their balance-sheet. This is too low to prevent conflicts of interest (vested interests) and a domino effect, and should be raised to at least 20% if the securitisation approach were to be implemented. Instead of risk sharing, the model put forward could therefore lead to less control of risks and an increase in moral hazard. This is of particular concern with regard to pension funds. Transferring part of the risk to pension funds would be dangerous and could be detrimental to future pensions. It should also be pointed out that this process must not impose any pressure or threats to existing first and second pillar pension systems.

Although the STS approach is described by a wide variety of commentators as ultimately still very complex, this technique is being encouraged. In addition, while it can be contested that SMEs could access capital markets for financing, the European Commission states that "the methodology would result in a significant reduction of the capital charge for non-senior tranches of STS securitisation". This will increase bank profitability without any impact on growth and jobs. The promotion of non-bank credit intermediation, which is the official goal of Capital Markets Union, in fact boils down to a regulatory subsidy for market-based banking and will increase interconnectedness, procyclicality and leverage.[1]

Therefore, while the ETUC is not opposed to building a more integrated capital market in the European Union, we are sceptical about the effects of such a framework on growth and jobs, and raise important concerns regarding financial stability. The CMU project, especially through the relaunching of securitisation, will incentivise financial actors to re-enter a casino economy by focusing on short-term profits and packaging fees, leaving the real economy aside. In other words, the European Commission is rebuilding a crisis-prone model, which is exactly what has brought us to where we are today.

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[1] *La Commission européenne ou le risque de «financiariser» la croissance, Libération, 24 May 2016, signed by 60 world-renowned economists.*