Opening remarks

Anneli Tuominen, Director General of Finnish Financial Supervisory Authority at the 4th FIN-FSA Conference on EU Regulation and Supervision in Helsinki on 9 June 2015.

Introduction

Dear guests, ladies and gentlemen,

Welcome to the 4th annual FIN-FSA conference on EU regulation and supervision. This year we will focus on the European Commission's recent initiative on Capital Markets Union (CMU) – how it could contribute to the growth of the European economy and lower barriers to cross-border investment in the EU.

We have once again managed to attract a list of distinguished speakers and panellists. I am also confident that you in the audience will contribute to the discussion as actively as in previous years.

Now, let me turn to today's topic. I will start with a few words on the current economic situation and follow with potential obstacles to funding – and the opportunities brought by the CMU. Governor Liikanen will touch upon the implications of ECB monetary policy and Professor Hyytinen will analyse the importance of capital markets to growth. Deputy Director General Guersent from the European Commission and ESMA Chair Maijoor will in turn elaborate on the CMU.

The current economic situation

As we all know, the long-term economic outlook for Finland is challenging. The Finnish economy is now suffering the consequences of a series of major structural changes due to the sharp fall in the ICT sector and the paper industry. The Finnish economy is also struggling with regards to competitiveness, which the new government is committed to address. While the economic recovery shows some broadening positive signs in the euro area, in the medium term we are still expecting to continue in an environment of low growth and low inflation. GDP growth in Finland is forecast to remain at a low level for the next decade.

At the same time we are facing a demographic shift with an ageing population whereby the share of the working age population is rapidly declining. The rest of Europe will face the same problem in the years to come. There is a need to vitalize the economy and secure the welfare of our citizens through actions towards growth. One key prerequisite for economic growth is to ensure that the financial markets are in a position to allocate funding efficiently to productive investments.

In Europe, the role of banks in the funding of businesses is more dominant than in the United States. We can even speak of over-reliance on a bank-centred lending model, as in Europe over 70 per cent of corporate lending comes from banks. Banking sector assets amount to approximately three times GDP in Europe whereas in the United States they are only about 90 per cent of the GDP. That has its implications, especially in times of financial crisis. During the financial crisis banks in peripheral countries had to deleverage their balance sheets and corporate lending dropped significantly, leading to slow or negative growth.

In Finland, the reliance on bank lending is accentuated by a strong concentration in the banking sector, which in fact measured by market share is the most concentrated in the whole of the EU. However, in Finland bank lending has at least until now demonstrated a steady growth. The problems in attaining credit are concentrated in the SME sector due to a lack of acceptable collateral. These companies also have a shortage of alternative funding providers, such as equity investors. The weak economic outlook has also had a negative effect on credit demand, and investments have remained low for several years.

Nevertheless, we are not observing only negative news about our economy. On the positive side, activity on the listing markets has been growing in the past year both on the stock exchange and on the less regulated First North. Corporate bond issuance has also remained active.

Moreover, if we look at start-ups in Finland, they are attracting international investors in growing numbers. The annual Slush event has rapidly grown into one of the world's largest start-up events and we are beginning to see more and more innovative companies with high growth ambitions. Unfortunately, it seems that currently their perception of the availability of capital for growth from European or Finnish investors is not that encouraging. It seems to me that their objective is rather to attract US venture capital money and ultimately list their shares in the United States.

What could be done to activate capital market finance?

In the past few years, there has been a flood of new regulation in the financial sector to address the weaknesses that led to the financial crisis. Partly due to the huge work-load, regulation has perhaps too often been prepared in sectoral silos and in a great hurry.

It is therefore extremely important to make an overall assessment of the legislation in order to identify and align or repeal potential overlaps or inconsistencies as well as any disproportionate impediments that discourage investment in or access to the capital markets. Any new initiative should be based on careful consideration and impact assessment. In this regard, I welcome the Commission's better regulation agenda, which stresses the importance of impact assessments and public consultations.

Before proposing new legislation the Commission should also assess whether the issue is really a regulatory or a supervisory problem. It seems to me that many of the recent misconduct cases, for example, do not necessarily require additional legislation but rather more intrusive supervisory action. The role of the European Supervisory Authorities – ESMA, EBA and EIOPA – is to ensure that the single rulebook is consistently applied throughout the EU. Supervisory convergence must be at the core of their work in the future – as well as at the core of the ECB.

Investors in capital markets require information for their investment decisions. But what is the right balance between investors' need for information and companies' reporting requirements? The amended Transparency Directive, which will be transposed by the end of November this year, eases the administrative burden by abolishing mandatory quarterly reporting by listed companies. Thereafter companies will be able to adjust their reporting frequencies, but they will naturally need to bear in mind the information needs of their investors.

There are also a number of other quick fixes in EU legislation that could improve the functioning of the capital markets in the short or medium term and to a certain extent also address home bias.

One quick fix could be provided through revision of the prospectus regime, which has become extremely onerous. I would argue that prospectuses are nowadays more of a liability management tool than an information package for investors. Retail investors hardly ever read prospectuses and I doubt that even institutional investors read them thoroughly. Even though the proportional prospectus regime that was introduced a few years ago has been used rather widely in Finland, it has not broken through in all Member States. An overall revision of the regime would lower barriers to accessing capital markets. Established listed issuers should be allowed to seek new capital with less stringent disclosures than companies that are still unknown to investors. Retail investors on the other hand should be provided with a simple and easy to understand information sheet, something similar to what will be provided through the upcoming regulation on packaged retail investment and insurance products (PRIIPs). The prospectus regime could also be complemented by creating a proportionate pan-European regime for information to be published in connection with crowdfunding.

Another quick fix could be done with regard to the availability of credit scoring information. Improvements to the availability of such information would lower the information barriers in non-bank lending. Credit ratings are too burdensome and expensive for smaller companies. More mechanistic credit scoring based on financial information published by the company would ease assessment of the creditworthiness of an issuer. This may also require initiatives with regard to electronic access to corporate information and further harmonization of the accounting standards for non-listed companies in order to ease the accessibility and comparability of financial information across the EU. Non-bank lending could also be supported by creating more standardized terms and conditions for private placements. In my view, however, this doesn't require regulatory action, but rather action by market participants.

A third quick fix may be needed with regard to making analyst research more accessible. I welcome the initiative taken by NASDAQ OMX Nordic to increase the availability of research by publishing financial factsheets of all Nordic listed companies. At the same time, I am a bit worried about the effects of the upcoming MiFID 2 legislation, which is about to bring new restrictions to the provision of analyst research in order to prevent intermediaries' conflicts of interest. Such restrictions may turn out to be counter-productive by de facto preventing investors' access to analyst information.

Capital Markets Union – is this a solution for us?

Can the Capital Markets Union provide a more diversified funding base for European and Finnish companies of all sizes? There are certainly positive elements in the Commission's initiative and every effort to improve the functioning of the capital markets is welcome. If the Capital Markets Union reaches its objectives, we will have a more diversified funding system and deeper European capital markets. Our companies will have a wider investor base and investors will have more opportunities to invest. Naturally, we would not like to see the marginalization of smaller markets like Finland.

I would also like to add that even though tax and insolvency laws fall under national discretion, steps should be taken at EU level to mitigate the current bias towards debt financing. I would argue that an increased use of equity financing would lead to a healthier and more resilient economy.

However, even with well-functioning capital markets, bank funding will probably remain the primary – and sometimes the only – source of funding for many small and medium-sized businesses. Therefore, even if the initiatives of the Capital Markets Union are implemented, it should be seen as complementary to the funding provided by the banking sector. Well-capitalized and resilient banks will continue to be a prerequisite for a healthy economy in the future. One thing I want to emphasize is that irrespective of the various stakeholders' needs, the capital requirements of banks and insurance companies should not be compromised under political pressure. Capital requirements should not be watered down and should always reflect the risks taken. They should not create wrong incentives, be it lending to sovereigns, SMEs or infrastructure.

Having said that, we could increase the role of capital markets in the funding of all sizes of business. Non-bank funding through for example corporate bonds, securitization and private placements is an important source of funding and its role could be increased significantly. For example loan funds play an important role in the United States, but they are still marginal in the EU.

However, we must ensure that we are not creating bank-like risk concentrations outside the banking sector. We need to make sure that such funding sources do not add too much leverage to the economy and that they are not too interconnected with the banking sector. One lesson that we have learned from the financial crisis is that different funding structures need to be transparent. Macro-prudential supervisors should be able to assess the systemic risks in the whole financial system and, where needed, have tools to counteract them. Another lesson is that supervisors need to constantly monitor financial innovations and assess the risks such innovations may impose to stability, market integrity or consumer protection.

Concluding remarks

Ladies and gentlemen, to conclude my remarks: the Capital Markets Union is certainly a welcome initiative. And it is important that it covers all 28 EU Member States and not only the euro area.

The Capital Markets Union is however not a panacea for funding growth. Even though more diversified funding channels will facilitate easier access to capital, small and medium-sized companies will probably continue to be reliant on bank funding.

The Capital Markets Union initiative reminds us of the importance of well-functioning capital markets as a facilitator of growth and productive investments. At national level, I think that we need an attitudinal change towards favouring investment on the securities markets. Retail investments should be seen as long-term savings, not as speculation.

Last but not least, one of the most critical issues for the success of the Capital Markets Union is the current lack of trust towards the financial markets and intermediaries in Europe. The capital markets will not revive, if trust cannot be restored. This requires action not only from regulators and supervisors but also from the actors in the financial sector. Acting honestly, fairly, professionally and in the best interests of the client must be placed at the core of the corporate culture of all financial intermediaries.

Ladies and gentlemen, I thank you for your attention.