



2023

*Europe - U.S. Symposium on Building
the Financial System of the 21st
Century*





EUROPEAN CENTRAL BANK
EUROSYSTEM



Ongoing Capital Market Reforms in Europe, U.K. and the U.S.

Contrasting challenges, part 1

- EU: Quest to build a European market
 - Deeper capital markets needed to fund large-scale long-term investments for economic growth, the green transition, and digitalization
 - Where will the capital come from?
 - Private pension funds are important, but remain elusive & politically sensitive
 - Life insurers long horizons, but stifled by Solvency II
 - Retail investors should want new options, but still wary of taking on risk
 - CMU as “hardy perennial” since 2015
 - What is realistic?
 - Consolidated tape, “leveling up,” centralization?
- UK: managing divergence and finding new markets
 - London remains biggest center for European finance
 - From rule-maker to rule-taker, esp. in new areas like ESG & crypto
 - Wisely taking on methodical review of regulations from a cost-benefit perspective (“E for Effort”)

Contrasting challenges, part 2

- U.S.: Everything, Everywhere, All at Once
 - Market participants largely skeptical of need for major change in many areas
 - SEC has introduced 40-50 materially significant rules under consideration
 - Doubts about rule-making process and cost-benefit analysis
 - Overwhelming ability of market participants to react to proposals
 - Unclear how myriad proposals will interact with each other
 - SEC rulemaking agenda may exceed legislative mandate
 - Legal challenges likely
 - Will significant parts be reversed in next administration?
 - Increased uncertainty about the future shape of capital markets



EUROPEAN CENTRAL BANK
EUROSYSTEM



Capital Markets Union

- *“France hates capital, Germany hates markets, and the U.K. hates union”*
- Obstacles
 - Local markets fear demise
 - Desire to invest local capital locally
 - Lack of investor base, including risk culture, defined benefit pensions
 - Disharmony between national withholding tax and insolvency regimes
 - Lack of pan-Eurozone bond issuance
 - Lack of banking union
- Progress
 - Commission, Council, and Parliament have committed
 - But time-limited by upcoming change in Council/Commission, so need to focus on achievables
 - Maybe consolidated tape? Others?
- Investor alternatives to capital markets
 - Financial sector still bank dominated
 - Will private markets dominate risk capital?

Technology and capital markets reform

- Blockchain has potential to improve back-end
 - Could change settlement from T+1 to T+0
 - May also improve custody, clearing, asset transfer, data disclosure
- Are digital tokens the future of investing? If so, why?
 - May be attractive to emerging retail investors
- Challenges
 - Must first solve scalability, sustainability, and security
 - Not fast enough for trading
 - Will disintermediation harm real economy, increase contagion?



EUROPEAN CENTRAL BANK
EUROSYSTEM



Recent Stresses in the US and European Banking Sectors



Bank failures vs. banking crisis

- Are recent bank failures idiosyncratic or portend of crisis?
 - And who is to blame?
- Bank management
 - Concentration, uninsured deposits, failure of hedging point to bad risk management
- Supervisors
 - Should have been monitoring and modeling for interest rate risk
 - After identifying a problem, supervisors were hesitant to force a solution
- Macro conditions
 - Rising inflation and interest rates – predictable shifts from bank deposits to money market funds
 - Can banks prepare for possible recession, commercial mortgage crash?

Managing bank failures

- Lender of Last Resort versus Self-Insurance
 - Is there any level of capital or liquidity that can allow banks to survive runs?
 - LOLR is only guarantee of sufficient liquidity
- Challenges of LOLR
 - Fed can only lend to solvent institutions
 - Fears of moral hazard: how can central bank avoid becoming lender of first resort?
 - Stigma of discount window lending
 - Operationally, need to improve speed, process, availability – from “bankers’ hours” to 24/7
- Resolution/Bailout
 - Can we distinguish between liquidity crisis and solvency crisis?
 - Options: government takeover/bridge bank vs. private purchase/takeover vs. insolvency
- Credit Suisse
 - Proof that resolution plans don’t work? Or that advance planning still pays off?
 - Is private purchase always best?
 - Did bail-in-able capital work as intended? And would EU have done the same?

Challenging conditions still ahead

- Potential for contagion
 - Where are the interconnections?
 - Will stress move to NBFIs? Where?
- Higher interest rates
 - Effects have not fully played out yet
 - Knock-on effects in commercial real estate, recession?
- Are digital runs the wave of the future?
 - Rumors and withdrawals move at light speed – less time to act?
 - First Republic didn't go as fast, but still went down
 - Or did SVB just highlight dangers of undiversified deposit base?
 - Need to supervise more effectively
 - Can better communication stop social-media driven runs?

Keeping banks safe in adverse conditions

- Is the answer more of the same?
 - More capital, liquidity, supervision
- Deposit insurance expansion
 - Under Dodd-Frank Act, FDIC cannot guarantee deposits at solvent banks without Congressional authorization
 - Moral hazard concerns
 - Politically unpalatable
- Accounting for bank assets
 - Marking to market versus hold-to-maturity accounting
 - Did accounting rules contribute to recent bank failures?
- Narrow banks not the answer

UPCOMING EVENTS

2023

China - U.S. Symposium
September 13-15, Hong Kong

Japan - U.S. Symposium
November 16-18, Karuizawa, Japan

To receive an invitation to other PIFS Symposia,
or to recommend your colleagues for participation, please contact:

Whitney Vasey

wvasey@pifsinternational.org | 857-242-6072

www.pifsinternational.org