

Católica Global School of Law



*Why the European market depend so much on the banking system when compared to capital markets?  
A comparison with the United States reality.*

Patrícia Domingos

*Master of Transnational Law Dissertation*

Supervisor: Jan H. Dalhuisen

April 2019

**Table of content**

Key-Words

Introduction

- 1. Financial systems in Europe and in the U.S. - Structural differences.....5
- 2. How U.S. and European Union banking system are different.....8
  - 2.1 What happened to these banking systems after the crisis?.....10
  - 2.2 Banking Union.....12
- 3. How U.S. and European Union capital markets are different.....16
  - 3.1 Stock Exchanges.....18
  - 3.2 Capital Markets Union.....20
  - 3.3 Capital Markets Union vs Banking Union.....24
- 4. Afterall why is there such a heavy reliance on bank lending in Europe? .....26
- 5. Bank-based or market-based finance.....28
- 6. Challenges for the future of the financial system and next steps .....32

Conclusion

References

**Keywords**

Bank-based finance; Banking Crisis; Banking Union; Capital Markets Union; Financial Regulation; Financial System; FinTech; Market-based finance; Stock Exchange.

## Introduction

Back to the early nineties, Europe's banking system has expanded unexpectedly lots faster than most other banking systems and turned out to be strongly bank-based until today especially when compared with other advanced economies like the U.S.. There are actually concerns that Europe's dependence on the banking system means approximately eighty percent of credit provided through banks and only twenty percent through markets.<sup>1</sup>

Due to the close links among financial systems and macroeconomic outputs the question arises whether Europe's constantly dependence on banks has and is affecting the stability, growth, and development of its own economy.

Huge crisis had shown us major flaws in the traditional conservative banking system, we had several proves on how banks were failing, keep failing and will fail again and again.

Is so, tremendously curious that all these failures weren't enough since we still deal with this bank-based dependence until these days. Why is that? Is it conservatism? Aversion to risk? Is it a policy issue or a historical option? A way of conducting business, institutional reasons? Is it the quality of the financial market products offered in Europe? The interest rate? Why capital markets always sound so distant and difficult to reach? A cultural tendency or the feeling of having no options?

Another question that emerges to me is how the E.U. citizens stay so inert without looking for diversification for themselves, for their savings, for their firms, without looking for alternatives that would better benefit them. Why aren't capital markets, most of the times, even considered, especially, when we stop to reflect and remember that even banks are thinking in ways to diversify themselves through it.

I truly believe the more developed and easier the access to financial markets, the better life is. I really cannot conceive why it seems so difficult to achieve a better model for Europe or at least a model that consider an option.

In my personal opinion, the policy prescription should be to develop stock exchanges creating an environment of corporate governance that support them and it's public shareholders, not the other way around. That way, investors as individuals or even the Small, Medium Enterprises "SME's" type of business will have alternatives sources of finance, they could raise

---

<sup>1</sup> Shoemaker Dirk and Darvos Zsoltt, 2018, Institutional Investors and development of Europe's Capital Markets, Chapter 18 in Busch Danny; Avgouleas Emilios; and Ferrarini Guido, Capital Markets Union in Europe, Oxford University Press, 2.

new capital even accessing foreign sources of capital instead family, friends or the usual banks that are no longer even lending as much as they should.

Somehow, this is still not happening, European companies are still relying far more heavily on bank lending with just little percentage coming from the corporate bond markets, almost the inverse of what happens in the U.S..<sup>2</sup>

Let's now take a deep look on what has been done so far and on what is actually happening while comparing the European and U.S. realities in order to better understand what we are really dealing with.

---

<sup>2</sup> ECMI Statistical Package, 2018.

## **Chapter One**

### **Financial Systems in Europe and in the U.S.**

#### **Structural differences**

Financial systems have, as we know, vital functions on how to allocate resources in a modern economy and on channeling household savings to the corporate sector allowing households and companies to share risks, enabling the transfer of economic resources in time and space across borders and among sectors, facilitating risk management through this diversification.

They condition the levels of economic growth, playing an increasing role. Identifying the key elements of a certain financial system and its core functions, as well as its development trends is fundamental to understand how the worldwide economy works and connects.

Typically, we can distinguish between two types of financial systems, those based on the banking system which is the cases of Germany, Japan or France and the ones based in capital-market such as U.S. and U.K..<sup>3</sup>

A strong financial system is always composed through its currency representing the mean of payment and reserve of value; through its financial instruments which channel the resources from the agents who have them to the ones who need it; through its financial markets, allowing the purchase and sale of the above mentioned financial instruments in a quick and not so costly way, and, through the financial institutions as the supervisory authorities that provide market access and information on the quality of the players representing a core role ensuring the functioning of payment and settlement systems while facilitating transactions through the development of a variety of financial products.

On what concerns to banking we need to be aware of the structure and shape which varies hugely from country to country being regularly an outcome of the regulatory reality they live by, which, as we will see, says a lot about this research question.

Banks take the deposits from the public, become owners of these deposits and issue loans at their own name and risk, depositors, on the other hand, became creditors. Individuals and firms deposit all their current funds on such institutions which means they should have enough confidence in this system.

They are the providers of the main source of funding or liquidity once they keep one's current funds in a check and a saving account or in a money marketplace deposit account and

---

<sup>3</sup> Allen Franklin and Gale Douglas, 2000, Comparing Financial Systems, MIT Press.

represent the place to get a home mortgage, a personal or a commercial loan and the place where individuals are able to park their cash and get into the payment system, at least the payment system as we are used to see until these days, which as we will see on Chapter 5 and 6 is changing.

On the other side of the coin, we have the financial markets that are the best result of a process of continuous changes that are still happening and can be traced back to the seventies to the collapse of Bretton Woods.

Bretton Woods, set, back that time, as a countermeasure to the great depression several banks restrictions to prevent banks from taking unnecessary risks <sup>4</sup> a new framework of regulated fixed exchange rate imposed to control the financial flows relating all major currencies to the U.S. dollar which was tied to gold reserves.

Well, as a result, the crisis was almost solved during that time, capital controls were back then centrally regulated at a national degree which resulted in the well-known closed financial markets. International manipulations of currency and securities markets became nearly impossible and everything culminated with deregulation policies on the late nineties since the system was obviously overvalued.

The deregulation boosted the proliferation of large megabank's, the so called universal banks that were able to offer the overall variety of banking services, together with non-banking financial services, under one legal entity.

What happened was that these banks started, however, to engage with risky market-based activities increasing the exposure to maturity disparity and systemic risks.

Bretton Woods cleared the way to overseas participation of capital markets in different international locations, the financial structure became thus grounded in supra-national organizations and free capital markets all around <sup>5</sup> which totally contributed to the great development of financial improvement once the degree of regional and international integration is a major aspect until these days. Integration increases the possibility of economies of scale in markets which, consequently, diminished operating costs for banks and increases the level of performance. Internationalizing this integration had a tremendous positive impact once increased the available capital in the economy and efficiency in the intermediation of funds and risk management. <sup>6</sup>

---

<sup>4</sup> Allen Franklin and Gale Douglas, 2007, An introduction to financial crisis, University of Pennsylvania 3-4.

<sup>5</sup> Biondi, Yuri, 2016, Empowering Market-Based Finance: A Note on Bank Bailouts in the Aftermath of the North Atlantic Financial Crisis of 2007.

<sup>6</sup> Kono, Masamichi and Schuknecht, Ludger, 1999, Financial services trade, capital flows, and financial stability, WTO Staff Working Papers, World Trade Organization, WTO, Economic Research and Statistics Division, Geneva, 6.

Numerous other factors contributed, naturally, at some stage, to trigger great transformation in the financial sector over the years as the per capita income and inflation; the political-economic orientations; the legal framework and the stability of each country regulatory institutions previously mentioned.

With the constantly integration and the increasing number of interconnected financial markets the difficulty of maintaining regulation and supervision at a national level increased, in particular, when referring to the various attempts at alliances among stock exchanges as we will discuss in Chapter 3, Section 3.1 or to the cross-border banks and financial companies mergers and acquisitions.

The balance between the banking system and markets of capital is needed and will allow the financial system to exploit the advantages of their complementarity <sup>7</sup> providing for stability.

European countries are experiencing a gradually global integrated growth of their financial systems, particularly, in the capital markets. Europe embraced several reforms on its financial systems aiming to increase efficiency and stability leading to progress towards greater financial liberalization which contributed to this global integration once, as we've just seen, allowed financial institutions to engage in consistent innovation accelerating the interconnectedness among institutions and markets worldwide.

Financial integration in Europe is finally advancing <sup>8</sup> however Europe still struggles to combine its banking and financial markets and there are plenty of structural and cultural reasons why capital markets in Europe are considerably less evolved and may never be as integrated or as harmonized as in the U.S..

There is a hope, however, on how to develop the European reality to more market-based reality named Capital Markets Union, "C.M.U." let's see how this could work.

---

<sup>7</sup> Davis, E. Philip, 2001, Multiple Avenues of Intermediation, Corporate Finance and Financial Stability, International Monetary Fund, IMF, Working Paper n° 115, 21-23.

<sup>8</sup> European Central Bank, 2018, Financial integration in Europe, Chapter 1: Financial integration in the euro area: recent developments, 11.

## **Chapter Two**

### **How the U.S. and European Union Banking Systems are different**

As we've seen in Chapter 1, banks are historically deeply involved in the economic welfare of a country's people, they are the main financial actors in a bank-dominated economy, they dominate, they are large and they extend credit not equity. On the other hand, when they fail they originate the well-known banking crisis and usually make space to crashes in asset prices which means to create the famous bubbles.

The first bank in the U.S. became chartered back in 1791 inspired on the charter of the Bank of England. History has usually judged the first bank to have been a success not only in terms of profit but also in the method of operation. Its charter expired in 1811 and by that time it had already acquired most of the functions of what we know today as a central bank. The second bank of the U.S. didn't experience the same strike of success of its predecessor, as foreign ownership, mismanagement varying from poor judgment to fraud were added to the equation.

The early history of American banking system shows us that banks have always been identified through their engagement in numerous types of deposit taking and transfer, having governmentally been authorized restrictions on other types of activities typically restricting them to credit granting exchanging or prohibiting engagement and participation in securities ventures.

When the free banking acts passed around 1840 allowing commercial banking and securities to be combined the problems arose.

By the time of the civil war and the concomitant need for bond selling by the national banks, the federal government needed them to distribute government securities to finance the war. The bank bought and either held or resold the government securities. The large extent of securities invested introduced others into the business and expanded the specialization of enterprises in securities activities. While commercial banks were in the business, both, private banks and stockbrokers became more evident and national banks were definitely not pleased with the new competitors.

Consequently, national banks, considering the fact that they need to have some funds available upon the call of depositors, decided to invest some of their assets in liquid investments, which means that for their own account banks started to have bond departments to handle these investments.

After the Great Depression of 1929, the U.S. financial system was heavily regulated, monetary and credit activities multiplied both in commercial and investment banking so did the number of private and incorporated banks. Private investment banking remained unregulated on the federal stage up to 1933. The *four Glass Steagall sections of the Banking Act, 1933* were launched to discourage collusion among corporations in the banking sector and to prevent another financial crisis stating that commercial banks were not allowed to underwrite securities with exception of municipal bonds, U.S. government bonds, and private placements.

Investment banks were, back then, prohibited from offering commercial banking services until the act was repealed in 1999 through the *Gramm Leach Bliley Financial Modernization Act GLB* signed by President Clinton.

The American economy grew and prospered in the following decades without major upsetting the confidence of investors in the financial system.

In the late twentieth century, the financial system followed the pace of growth that the world economy was experiencing. Securities activities took their place on the market, institutions began to underwrite securities and sell them to national banks which started to established securities affiliates to involve in securities activities.

While innovations and restructuring were changing the financial system, legislators and regulators were dismantling the previous imposed controls and restrictions that characterized the U.S. financial system post great depression as it was the case of some interest rates ceilings, controls on international capital flow, direct limits on credit expansion and so on.

On regard of the European reality and preceding the financial crisis, the banking system in Europe was growing, and, curiously, one of the reasons pointed by the doctrine regarding this growth trend before and even after the crisis was precisely the contemporaneous rise in the wealth of the European households.<sup>9</sup> Lending to households in Europe continued to increase, however, at a slower pace today than in 2015 and 2016 as revealed through the ECRI Statistical Package from 2018.<sup>10</sup>

We assisted to a banking system grew that did not follow the economic activity pace with high short-term gains, low credit standards and misalignment incentives in securitization besides a super-fast cross border business expansion, which, plus to the aid provided from the European banks to the American ones, culminated on the crisis as we know it.<sup>11</sup>

---

<sup>9</sup> Piketty, Thomas and Gabriel Zucman, 2014, Capital is back: Wealth-income ratios in rich countries, Quarterly journal of economics, 1289-1290.

<sup>10</sup> Bouyon Sylvain, Pietro Gagliardi, 2018, Lending to Households and non-financial corporations: growth and trends in 2017, ECRI Statistical Package 2018.

<sup>11</sup> Committee on the Global Financial System, 2018, Structural changes in banking after the crisis, 12.

## **2.1) What happened to these banking systems after the crisis?**

Quickly remembering the crisis we experienced in the past, we had the global crisis of 1825 with its origin in the United Kingdom affecting Europe and Latin America; the great panic of 1907, a global U.S. origin crisis with strong repercussions in Europe, Asia and Latin America; the great depression of 1929, already mentioned, a global major crisis that started in the U.S. and spread to all continents; the debt crisis of the 1980s and a sovereign debt crisis involving several developing and emerging economies in Africa, Latin America and Asia where many countries have initiated hyperinflationary dynamics and the what so-called second great depression 2007 to 2009, a systemic banking crisis associated with huge volatility in U.S. based exchange markets that quickly spread to all major international financial markets, with huge repercussions in Europe.

The frequency of worldwide financial crises led to a rebirth of the debate on their costs and causes as well as on the policies capable to avoid future occurrences.

From a broad perspective, we can understand financial crisis as a major disruption in one or several financial systems characterized by a significant decrease in the value of assets and often leading to the bankruptcy of numerous financial and non-financial institutions. Financial crises often manifest themselves in periods of weak growth, deterioration of public accounts, accumulation of excessive budget, deficits, deterioration of external accounts and some other negative macroeconomic contexts, by means of example, with sharp rises in interest rates which means only the highest risk investment projects are able to satisfy the debt service and those are usually, precisely, the investment projects that are most likely to fail due to the problems of adverse selection that will follow the lead and increase, the same on regard of financial costs.

Also, is good to remember that the already mentioned international integration of financial markets promotes the contagion phenomena once crisis are inseparable from the globalized markets and that was precisely what happened in our last crisis.

By mid-2007 the tension began to deepen financial markets worldwide. With the bankruptcy of the Lehman Brothers, one of the world's largest investment banks, a difficult period in financial markets was launched, characterized by a sharp rise in the overall level of risk and a sharp fall in liquidity as a dizzy reduction of capital flows around the globe.

In 2008 the world was plunged into the worst economic financial crisis since the 1929s with the global financial system threatening to collapse.

This was considered by many economists as one of the most serious crisis which resulted ultimately in several government bailouts, in the bankruptcy of numerous financial institutions and in deep falls in financial markets. The crisis revealed in several phases, the U.S. real estate prices reached their limit in 2006 and around mid-2007 the rise in the default in the subprime market where high-risk loans with high interest rates were therefore practiced in the U.S. led to the bankruptcy of the first financial intermediaries related to mortgage credit funds.

European banks were hugely affected due to the aid they provided to the American banks and also due to the fear they had of bankruptcy and the gradual uncontrolled loss of confidence installed in its banking sector.

The degree of sovereign indebtedness registered also a sudden increase and what has started as a banking crisis quickly turned into a sovereign debt crisis. Cross-border structures hugely declined due to fears of contagion. This whole environment naturally called into question the public confidence in the banking system as a whole.

In reaction, which is usually one of the direct consequences of these crises, regulators pursued bold financial reforms aiming to transform the financial system into a resilient system to systemic risks by strengthening the financial regulation and supervision which is continuous development is a fundamental issue <sup>12</sup> once the crisis final impact on a system totally depend on how powerful management is executing the roots of the problems or not.

What we have been witnessing is an obligation on banks to raise enough capital to recover from these moments and to attain at least the minimum level necessary to secure their functions, the subsequent periods of adaptation and improvement of the quality of capital allowed a transitory choice for these banks among the opportunity to reduce capital or close certain lines of activity in order to better fit certain and more favorable regulations.<sup>13</sup> European banking supervision was thus about to become a reality as we will see.

The painful lesson of 2008 was that banks with high leverage besides transmitting external shocks surely make a contribution to expand these shocks through the self-reinforcing downward spiral. We cannot remove these external shocks, but we can break the spiral through extra resilient intermediaries. Pressures faced by banks as borrowers contribute to the downward trend seen in bank leverage on the capital markets perspective. The challenge for policymakers is precisely to mitigate these potential systemic risks originated most of the times by the deleveraging reactions of the intermediaries themselves.

---

<sup>12</sup> Dale, Richard, Bruni, France and Boissieu, Christian., 2000, Strengthening Financial Infrastructure. Deposit Insurance and Lending of Last Resort, Société Universitaire Européenne de Recherches Financières, 16.

<sup>13</sup> *Ibid.*

Basel III framework introduced several provisions that may also be able to reduce leverage in the financial system due to their strict connection to financial stability, and consequently, minimize problems of liquidity, reverting it.

While it is still being completed, we may have the quick feeling of a more stringent regulatory standard getting shaped and that something is being done which has already improved banks' capital structure and consequently confidence is being rebuilt<sup>14</sup>

It is by now clear the unpleasant scenario we may face when financial stability mechanisms are not effective on safeguarding the arising of a new crisis.<sup>15</sup>

## 2.2) The Banking Union

Back in June 2012, the euro area was as we've seen, a bad place to be if we were a bank, a country or an investor. A huge loss of trust in the markets was being faced.

The Banking Union, "B.U." represented a fundamental change in how banks are supervised in Europe. It represents the insurance that the banking sector is safe and reliable after the enormous financial crisis we were living. From now on, if problems occur banks can be resolved without using taxpayers' economies.

Two fundamental pillars contribute to the banking union, two mechanisms based on the same rules and principles adopted by the E.U. to make the financial sector safer after the financial crisis applying to all banks operating among the European Union, the Single Supervisory Mechanism "SSM" and the Single Resolution Mechanism "SRM", both mandatory for all euro area countries and open to all other countries in Europe.

By the same rules and principles, I mean, for instance, rules to make sure that all E.U. banks hold enough capital and act in a more responsible and sustainable way, savers are also much better protected and deposits of up to a certain amount are now guaranteed, these rules grant the same level of protection across the E.U. were especially designed to prevent panic withdrawals from banks in distress.

When the financial crisis turned into the Euro Zone debt prices became clear that banks in countries that share the euro currency were more interdependent which means ultimately that they would need and benefit from the same supervision and resolution. One of the reasons why the crisis was so onerous to Europe was precisely the fact that a significant part of the public

---

<sup>14</sup> Dalhuisen, Jan H., 2018, *op. cit.*, 578-580.

<sup>15</sup> Tartullo, Daniel K., 2016, Financial Regulation since the crisis, speech.

debt was subscribed by the national banks of the most indebted countries. When banks invest heavily in debt of another government and governments are dependent on banks to buy the debt, when and if one's fails everything may fail and the consequences can be devastating.

Bank supervision was, in Europe, until 2014, a national concern even though the range of European banking operations was already international.

In order to avoid another financial crisis, the B.U. moved banking supervision to the European level. A single supervisor was then created in the euro area, the European Central Bank "ECB" was established as a prudential supervisor of all significant eurozone banks and to other countries that joined the system which represents the SSM pillar.

The ECB directly supervises the most important banks while national supervisors continue to supervise the remaining banks under the central bank guidance. Their main task is to ensure that banks comply with the new established rules and that emerging problems are immediately solved.

Among the new functions of the ECB are the establishment of a stable financial system and the recovery of the economy; the early detection of bankruptcy by credit institutions; the control of the health of banking activity including the way banks accept and invest deposits of its depositors and the penalization of banks that do not comply with the new higher standards.

Also, the crisis experience shown us, as mentioned, that besides banks were not able to support their losses, autonomously, the final incumbency rested on the taxpayers. The Commission launched thus a step-by-step to crisis management among the financial sector <sup>16</sup> aiming to maintain stability in any further event of failure.<sup>17</sup> The concept of a European responsible authority for managing crisis arose as a framework to deal and coordinate the consequences was already supported by several authors from the after crisis as it is the case of *Fonteyne et al. (2010)* <sup>18</sup> or even *Dewatripon et al. (2010)* <sup>19</sup>

Until the beginning of the crisis there was not much international experience regarding large and complex banks in difficulty, especially when referring to different jurisdictions. Banks facing a serious crisis usually either applying to insolvency; bail-out with public money or apply for settlement.

---

<sup>16</sup> European Commission Communication, 2010, An EU Framework for Crisis Management in the Financial Sector.

<sup>17</sup> European Central Bank, 2011, The new EU framework for financial crisis management and resolution, Monthly Bulletin, July.

<sup>18</sup> Fonteyne Wim, *et al.*, 2010, Crisis Management and Resolution for a European Banking System, IMF Working Papers, 5-11.

<sup>19</sup> Dewatripont Mathias, *et al.*, 2010, The role of state aid control in improving bank resolution in Europe, Bruegel Policy Contribution, 1-9.

Today, in thesis, if a bank fail and need to be resolved, taxpayers have no longer to step in since a new agency called the Single Resolution Board is in charge constituting the second pillar of the B.U. and intending to make European banking system much safer.

In a case scenario where a bank actually fails or is at risk of failing the SRM will come into play and all the necessary tools will be placed to resolve that bank efficiently, making sure the interest of the E.U. as a whole is being taken into account and the cost will be sustained by the private sector through a Common Resolution Fund<sup>20</sup> financed by the banking system over a period of eight years.

It's a banking union goal to assure financial stability to individuals that have nothing to do with bank's problems, especially in cases of fraud or negligence or where there are errors or problems in the bank records.

There was also a need for common and uniform treatment of depositors in order to enhance confidence in the banking sector and for the imbalance of a supra-national depositors protection system since there was no uniformity in the treatment and protection of the depositors among member states. A new deposit guarantee scheme directive was agreed back in 2014 named Deposit Guarantee Schemes Directive "DGSD"<sup>21</sup> which together with the SSM and SRM contributes to what we may call the third pillar of the B.U..

Through this new guarantee scheme protection, is given to the depositor, reimbursement through compensation, depositors should be protected in the event of insolvency, additionally, the Directive also recognizes the possibility of using the SGD fund as financing measure to avoid the insolvency of banking institutions.

Deposit guarantees have, as we know, positive effects on the protection of depositors and are fundamental to counteract the spread of bank crises, however, they have also some harmful effects. One unwanted effect is associated with moral hazard since deposit insurance creates incentives for one of the parties to develop actions that are detrimental to the other. They also have adverse selection effects since the ones with a major risk of bankruptcy are precisely the ones that are more interested in taking advantage of the insurance which makes the banking business very attractive to anyone who wants to be exposed to risk. Also, moral hazard generates a third problem, the *too big to fail*, once the bankruptcy of large banks produces serious effects on the financial system as a whole, there are banks that simply cannot be bankrupt once its bankruptcy would lead to major problems to the financial system. Regulators,

---

<sup>20</sup> Dalhuisen, Jan H., 2018, *op. cit.*, 577-578.

<sup>21</sup> Directive 2014/49/EU.

thus, have great incentives to hardly allow large banks to open bankruptcy in order to avoid bank run effect.

The B.U. is open to all countries in the European Union and intent to put an end to all the bailouts paid by taxpayers which is a very important issue, especially in this after crisis scenario where confidence needs to be reinstalled. Is one of the biggest steps in terms of European integration after the Euro and intent to restore stability and confidence in Europe and its banks, creating the right circumstances for the financial sector to lend accordingly to the real economy needs spreading growth and job creation. The B.U. is however still incomplete not only due to the deposit guarantee scheme that is still under discussion and will, if so, fully operate only in 2024 but also due to the resolution fund that is still being constituted too.

## Chapter three

### How U.S. and European Union Capital Markets are different?

Entrepreneurs with brilliant ideas who are looking for funding need to meet savers who are looking to invest their money.

To fund their businesses, small business individuals usually turn for families, friends or banks. Much smaller and medium enterprises in Europe still obtain funding through banks which still are the primary source of funding, however, as we know, banks have less lending capacity since the crisis.

If banks are the primary source of funding and are lending less and less, remembering that in Europe, it is estimated that there are around 24.5 million SMEs in the non-financial sector generating around 95 million jobs, representing 99.8% of the European business motor<sup>22</sup> and thus playing a key role in the European economy, turning that, just over one-third of the SMEs fail to get complete financing, what is happening here and, once again, where are the alternatives?

If banks decline credit application, most of the time, without even giving proper feedback when declining it and considering that we always will have unhappy savers for not having much return on their savings on the banking system, what we need is to create a good meeting room for these two compliment needs on the capital markets.

The option is direct funding from the capital markets, this would include public markets like shares and bonds and private markets like private equity and private placement.

Capital markets in Europe are unfortunately still underdeveloped when compared to other economies and they are also fragmented along national lines due to shareholders and buyers of bonds aversion on going outside their own countries when they intend to invest; savings are essentially locked in member states and they are too concentrated in the internal banking system, also, in Europe due to the different size and need for funding, corporations may have the preference to maintain family ownership control.<sup>23</sup> The result is that the one who needs financing and those who have savings never meet, yet.

There is a room for potential funding for businesses across Europe that's completely untapped, diversification of funding sources enabling borrowers to choose from the competing options, besides that, promoting efficient distribution of risks through risk sharing. It would

---

<sup>22</sup> European Commission, 2018, Annual Report on European SME's, SME's growing beyond borders.

<sup>23</sup> European Commission Communication, 2015, Action plan on building a Capital Markets Union, 12.

help other businesses to raise funds more easily and savers to get more from their money, that's precisely the goal from the Capital Markets Union as we will see further.

The C.M.U is a European Commission plan to cut boundaries, to cross border investments, to diversify the funding of the economy and reduce the cost of raising capital in order to support economic growth by increasing savings enabling them to become profitable.

Capital markets provide a vital financing source to economic activities by expanding the investor base beyond banks and by allowing diversification of investment enabling borrowers to choose from competing resources.

Today, in Europe, as noted, many start-ups and SME's find it too hard to get funding. Financing innovation start-ups and non-listed companies are the main initiatives of the C.M.U where its aimed to develop the potential of SMEs as they are the major part of the European business fabric and having that in mind, how is even possible that they are still fighting these greater difficulties in accessing the markets in particular by having their sources diversified.

Helping the reader to better understand, in capital markets we have the primary markets and the secondary markets. On the first, investors buy securities from the company issuing them, companies that intend to become public, express their intention and sell their new stocks through an Initial Public Offer "IPO". When this happens the company already hired an underwriting firm to review the offering and create a prospectus outlining the price, it's usually not a place for such small investors, for those, we have the secondary market where investors trade securities among themselves and the company with the securities being traded does not participate in the transaction, is that place where securities are traded after the company has sold all the stocks and bonds offered on the primary market, here, small investors, as we will understand sooner, are no longer excluded due to the small value they represent.

Some actions are already been taken on the way to easier access to the capital markets for individuals as investors and SME's also, as we will see. Is the case of stimulating venture capital and equity financing promoting innovative forms of corporate financing through crowdfunding; loan originating funds or private placement.<sup>24</sup>

Of course, we need to work the access of these companies to raise capital on public markets in order to make it easier, less costly and even so, transparent, reducing the regulatory barriers. The new directive on prospectus as we will see in Chapter 5 bellow is already versing on that, besides the hard work that still needs to be done, of course, it's a start.

---

<sup>24</sup> European Commission Communication, 2016, Capital Markets Union, Accelerating Reform, 1-10.

The bank dependence still reduces the promotion of diversification of active investors and easier access through secondary offers to equity and debt finance.

Let's now understand the stock exchanges operating around here:

### **3.1) Stock Exchanges**

Let's take a step back to 1995 where a lot of commotion regarding securities' markets in Europe arose. That was a time when stock exchanges around the world, one after the other, like a domino, particularly in Europe, started to convert into business owners aiming to make money. The original driver was the technology new era and competition from electronic computer-based stock exchanges that started trading securities that were traditionally exclusively traded in national platforms, the stock exchanges started to modernize themselves hugely.

We are talking about the late nineties early two thousand which means the rise of National Association of Securities Dealers Automated Quotations "Nasdaq". Nasdaq was around for decades but it was a very small market almost designated to the small entrepreneurs in the U.S.. There was also AMEX, the third largest stock exchange by trading volume un the U.S. that later on was absorbed by the New York Stock Exchange "NYSE", the largest of the organized stock exchange in the U.S..

Nasdaq was that big beautiful story that began as a telephone-based market among market professionals and once it was more flexible, appealed to entrepreneurs, since, through it, they had less demanding requirements for being traded on the market. Stock exchanges were more like an intern market among professionals and during the nineties, the big successes have already been proven as it was the case of Microsoft, Dell and we even can consider Apple that was a big name already. Nasdaq framed itself back then as a high-tech stock exchange, the future.

At the same time, new dynamic was installed in this market, the stock exchange became, as mentioned, a business corporation, facilitating, whoever was interested, to own or start a hostile takeover, merger or acquire a stock exchange.

In Europe, the feeling was of a lot of competition and quickly the European countries started to transform their stock exchanges into business entities too. That competition feeling was flamed primarily from Nasdaq, as we've seen, and right after from the NYSE that started to make deals for taking over other exchanges.

The E.U. created then an alliance that changed its name over the years and now is called Euronext that was essentially a network of stock exchanges in order to try to provide a viable alternative to Nasdaq.

What we see in the second half of the nineties is a series of traditional stock exchanges establishing a smaller market under the brand name “New Market”. We were able to find newer markets in Germany, Paris or Amsterdam they all appealed to the same kind of foundation, the high-tech entrepreneurial firms that could offer nothing but hope and had the biggest challenges in terms of information asymmetry. Good parallel with what we still have to deal nowadays.

The European stock exchanges faced a doubt when regarding these new markets, of increase or decrease their standards. By increasing it entrepreneurs would become liable and that’s a guarantee for investors, alternatively, by lowering it, besides the already known costs of regulation, the competition factor matter, once any extra requirement in terms of regulation might represent a disadvantage when compared to what the other countries had to offer once the entrepreneur can freely choose between markets.

For unknown reasons the all thing collapsed. We had by the end of the nineties a colossal failure among all the markets that at some point got together because of this push towards consolidation in Europe. It was an almost free regulation experiment hoping the business compensate for it. The all things collapsed hugely but not only because of the absence of regulation but also because of the business plan of the entrepreneurs remembering this happened during the nineties, beginning of two thousand when we had the dot com bubble.

As a cultural curiosity, let me add, that against this scenario comes the initiative of the São Paulo Stock Exchange “Bovespa” to create a new market called the “Novo Mercado” that everyone thought was totally unreal back then since it was a failed brand name and it had been already tried and failed by other economies, advanced ones. Somehow, they not only did it as they succeed it on it.

The Novo Mercado experience can be taken in several directions. If we believe that one of the factors to its success was the one share one vote system and the disclosures perhaps it represents a bad policy move on behalf of the Europe stock exchange since the Nasdaq as all other stock exchanges gave up on that model.

The other feature in Novo Mercado point to independent directors whereas in the traditional system we could have insiders and family members on the boards but here too it’s not entirely clear.

Maybe the one share one vote model is necessary, or the independent directors are a vital factor or even full alignment between cash flow rights and vote rights, having people in

charge in the board supervising it who are not related to the controlling shareholders makes all the difference. Maybe all of these reasons are helpful in some countries but not in others and that is precisely the message.

Bovespa also created levels among their stock exchange, a scale track in which honest hard work entrepreneurs could commit to better government without extract value from the companies. It's surprising and worth the analysis.

My point here is precisely to make it clear that the same mechanisms may work very differently in very different environments.

Mechanisms that are not needed, not efficient, maybe too costly in developed markets as the U.S. operate in a hugely different way in countries that face other difficulties as was the example of Novo Mercado that was readjusted to the reality of another country and experience and totally succeed.

This is something, in my opinion, super important to bear in mind especially when discussing and comparing integrated markets and their response to standardize procedures. Each country face a very different reality and we must always respect their identity at first.

Today in Europe we have a fragmentation of stock exchanges unlike the U.S., which is served by the NYSE and Nasdaq, there is no stock exchange which serves the whole of Europe, yet. We have Euronext covering the Netherlands, France, Belgium and Portugal that is the only large multinational exchange. From April 2007 Euronext joined the New York Stock Exchange founding the NYSE-Euronext "NYX" group.

The rules on trading in the market are now largely harmonized and are common to the entire NYSE-Euronext group.

The fragmentation we have in Europe is an issue to be developed and further studied by policymakers in the C.M.U. project, as we will see, since through fragmentation we will only continue to discourage issuance of new equity and the aim is precisely the opposite, to encourage the development of the financial ecosystem which has been deteriorated in Europe in the past years.

### **3.2) The Capital Market Union ("C.M.U")**

The Economic and Monetary Union "EMU" has contributed already to the integration and little diversification of assets, as we've seen, diminishing the obstacles to cross-border banking and consequently facilitating the risk sharing, although it's level is still much below

the level we can find among the U.S. which justify the need for new policy initiatives <sup>25</sup> as it is the case of the C.M.U. project which intent to increases the European attractiveness for investment.

After the successful beginning of the Banking Union, the query has been raised whether we ought to additionally develop Europe's Capital Market reducing, therefore, Europe bank bias presenting an alternative to the historically bank-primarily based financing channel providing new sources of funding for businesses and increasing option for savers.

The C.M.U. was firstly mentioned by means of President Juncker in a speech to the E.U. parliament on 15 July 2014 far strongly inspired by the North American market-based model wherein, as we know, the capital market contributes hugely to the financing of the economy than in Europe and has been from there on a key priority for his Commission.

In Europe, a suitable structure for market-based channels of finance remains lacking and the change of scenario it's urgent. <sup>26</sup>

The European equity markets are less than half the size American ones and the debt markets less than a third and curiously the gap among E.U. countries is bigger than the existing gap with the U.S..<sup>27</sup>

The priorities of C.M.U. are widening diversification of funding sources, dealing with the development of debt capital markets, securitization and bond market.

A especial concern are the SME's, due to their difficulties accessing finance <sup>28</sup> and considering the fact that European SME's receive five times less funding from the capital markets than the existing ones in U.S.<sup>29</sup> strengthen the potential to lend, diversifying funding channels, ensuring proper allocation and a better distribution of capital and risk, strengthening long-term investment, reducing obstacles to funding and facilitating cross-border investment offering to investors and savers additional opportunities, consequently, strengthening the ability of the E.U. capital markets as a whole which is vital.

As we will see in Chapter 5 fundamental changes to old models will always imply the review, flexibilization, and adjustment in order to modernize the already existent structures. On the case of the SME's one of the biggest adjustments will definitely be the prospectus regulation that is already being fully redesigned to meet the reduced market capitalization to start-ups and

---

<sup>25</sup> European Central Bank, 2018, *op. cit.*.

<sup>26</sup> Draghi Mario, 2019, Introductory Statement, President ECB at the ECON Committee of the European Parliament.

<sup>27</sup> European Commission Communication, 2015, *op. cit.*, 3.

<sup>28</sup> European semester thematic factsheet, 2017, Small and Medium-Sized enterprises access to finance, 1-10.

<sup>29</sup> European Commission Communication, 2015, *op. cit.*, 4.

SME's access to the capital markets, they can no longer be that onerous. Changes on prospectus are the main door to public markets.

The C.M.U. is presented as a complement to bank finance, not an attempt to replace it. Deeper integration of these two realities can contribute hugely to the maintenance of the cross-border capital flow as sustain investment around the diverse member states, contributing to the risk reduction in the financial sector.<sup>30</sup>

On contrary of what we see in the B.U. whereas two key pillars are comprised, the C.M.U. calls for a multiplicity of policy reforms in order to provide enough impetus to the improvement of securities markets.

Institutional investors, as professionals, typically, hold worldwide diversified portfolios of securities contributing to that financial integration and risk sharing. An integration through C.M.U. would soften the impact of economic shocks on expenditure and investment<sup>31</sup> promoting the stability of the financial system, unlocking new possible ways of investment. The diminish of cross-country barriers would rise international capital flows volume promoting integration and connection as previously mentioned and as was proven by *Sørensen et al. (1998)*.<sup>32</sup> Growth of institutional investors will consequently lead to development once the largest the assets managed by institutional investors the lowest the home bias is. The chain among savings and growth will be strengthened. Reduction of fixed access costs to access capital markets, at least to small and medium firms would encourage its active participation. We will always need a strong capital market reality if we intend to strengthen investment in the long term.

Numerous keys reforms are expected to contribute to the development of the stock market, the corporate bond market and markets for asset-backed securities. Some of these reforms were previously outlined in the Green Paper, *Building a Capital Markets Union*<sup>33</sup> presented by the E.U. Commission back in 2015. The Commission continues to work in ways to remove the existing barriers among investors money and opportunities.

Useful next steps to provide international diversification of the sources of finance would as previously mentioned on Section 3.1, include the integration of stock trading platforms in

---

<sup>30</sup> European Commission contribution to the European Council, 2019, Capital Market's Union: progress on building a single market for capital for a strong Economic and Monetary Union.

<sup>31</sup> Véron, Nicolas and Guntram B. Wolff, 2015, Capital Markets Union: a vision for the long term, Policy Contribution 2015/05, Bruegel, 5.

<sup>32</sup> Sørensen, Brent E. and Oved Yosha, 1998, International risk sharing and European monetary unification, Journal of International Economics and Darvas, Zsolt and Schoenmaker, Dirk, 2017, Institutional investors and home bias in Europe's Capital Markets Union. Bruegel Working Paper.

<sup>33</sup> European Commission, 2015, Building a Capital Markets Union, Green Paper.

Europe, comprising all the alternatives at one place, *Langfield, (2016)*, developing connections among local capital markets and deeper clusters of capital in Europe. Companies will thus become able to seek funding at a global level including by listing themselves on other stock exchange.<sup>34</sup>

During the last five years, Europe's Capital Markets has been developing market capitalization of listed companies which is now higher when compared to the crisis levels, the same to the cross borders distributions that are also grown and debt securities which show us, finally, a positive trend.<sup>35</sup>

Another important and critical event we need to bear in mind when discussing this topic is the C.M.U. without the United Kingdom which raises the policy question of how to regulate and supervise these enlarged capital markets especially at the same time, the U.K.'s exit from the E.U. generating this all new range of new policy challenges.

It is far well known that the U.K. commonly adopts liberal and pragmatic stances, typically related to much less legislation, much more self-regulation, and open markets. The lack of pragmatism should absolutely change the level of discussions in the area of financial services. Brexit involves natural risks for market integrity and stability once the member states have been almost dependent on the Bank of England and U.K. Financial Conduct Authority for the oversight of its wholesale markets, and now needs to deal with a huge swift and sustain its capacity to ensure market integrity and financial stability for themselves. Is also known that the U.K., by the size of its experience, its diversity and depth of its market has an expertise different from all the other member states which it will be a huge shortcoming on the negotiation table and a huge challenge to the development of European financial markets. On the other hand, once the eventual weaknesses of the European market become clearer, in principle, it will force the search for optimal solutions that reinforce the integration of markets to sustain liquidity and to combat the well-known fragmentation.

Let's hope this exit works as a fuel to accelerate the development of the C.M.U. and contribute to increase its resilience to asymmetric shocks moving quickly towards a fully integrated single market for financial services with harmonized rules and consistent supervision and enforcement.

---

<sup>34</sup> Langfield, Sam and Marco Pagano, 2016.

<sup>35</sup> European Commission contribution to the European Council, 2019, *op. cit.*.

### **3.3) Capital Markets Union vs the Banking Union**

Closer analysis of the B.U. and C.M.U. makes it possible to identify a very significant set of differences among these two, especially at institutional and regulatory levels. The B.U. comprises Member States of the euro area and those not forming part of the euro area under enhanced cooperation, on the contrary, the C.M.U. covers all the member states, being a typical policy of deepening the internal market.

The B.U. is institutional, rests on an existing institution benefiting from the advantages and suffering from the disadvantages of the status of the ECB based on its attributions and on the SSM with direct supervisory powers over a set of significant institutions and indirect supervision of the whole banking system. In the C.M.U. the central most relevant institution might be European Securities and Markets Authority “ESMA” which suffers however from the restrictions of institutional powers being a mere organization.

On the regulatory strand, the B.U. is based on the single rulebook that does not exist in the C.M.U.. The B.U. also does not exist without this centralized management system, without the harmonization of its prudential rules, supervisory powers, transparency, and agents' actions, on contrary, in the C.M.U. where there are numerous initiatives aimed at solving specific needs, properly identified, where there is also a common purpose to facilitate the access of SME's to the market by contributing to growth but still with some problems to be overcome.

The regulatory differences among B.U. and C.M.U. are also reflected in the lower normative density of initiatives integrated into the C.M.U. which often involve the production of reports, analysis, and evaluations by working groups whereas in the B.U. we face a formal legislative structure totally based on European Union regulations. The European legislation on capital markets has only recently been adopted by the Union, in a package such as the markets and financial instruments and the associated regulation initiatives in the form of directives.

Another regulatory element we may point out is regarding the fund assistance, the C.M.U. is assisted by a fund called Structural Reforms Support Program "SRSP" which is a European Union funding program for the period corresponding to the current financial perspectives until 2020 <sup>36</sup> its main objective is to financially support the member states in the definition and implementation of policies and structural reforms including policies in the financial sector. The C.M.U. is trying to add initiatives to strengthen investor confidence in markets and financial products by stimulating the opportunity to identify alternative investment

---

<sup>36</sup> Regulation 2017/825.

and foresee the market as a future savings product in order to encourage participation and involvement of investors in financial markets.

There are also differences in policy objectives between them, they clearly have common goals although the instruments and approach to reach them are totally unique. Both policies aim to strengthen the stability and security of the financial system as a whole.

The B.U. resulted, as we've seen, from the crisis initiatives of 2007 and 2008 and the C.M.U. in flip aims to restore the markets depressed after the same crisis and the regulatory weight that resulted from the solution to the crisis.

There are also some similarities among them, as they are both a way of deepening the internal market, the C.M.U. objectives are still a bit smoother than those of the B.U. where foundational instruments aim to create safety nets such as the resolution fund or the already explained guarantee system for deposits or the strengthening the banking system and prudential supervision.

The goals of the C.M.U. are to enhance growth and provide for alternatives, different sources of financing as an option to the banking channel, complementing it. In turn, the B.U. strengthens the banking system in the prudential and supervision aspects looking for providing, in their limitations, better answers for the public needs aiming at the prevention and resolution of bank crises and the improvement of the safety nets through deposit guarantee mechanisms and the resolution fund already discussed in Chapter 2.

## Chapter 4

### Afterall, why is there such a heavy reliance on bank lending in Europe?

European companies still depend much more on bank lending than corporate bond markets contrary to what happened in the U.S..

Could they potentially raise much more in capital markets if they were as developed as in the U.S.? Maybe, but we must face it, the reality is that many of these companies and individuals in Europe besides having a huge cultural suspicion of risk-taking and entrepreneurialism found a market not prepared to truly embrace our corporate tissue identity. The same for the size of the companies the U.S., they have many many large companies and also some medium companies which, on regard of the American experience, are not that small actually, they are quite large when comparing to the European reality.

It's undeniable they have better access to the capital markets while, still, borrowing from banks however the size of the market itself must be considered, as an important indicator for us to acknowledge.

European's saving habits also still happens through the banking channel, capital markets have no reflection on it, excepting insurance and savings in other channels such as pension funds that are also relatively small when compared to the U.S. reality, approximately one third scale of the U.S. relative to GDP, the same for asset managed by non-bank financial institutions.

European markets remain, as consequence, undervalued in comparison with other jurisdictions.<sup>37</sup> By the end of 2013, the E.U. stock market capitalization was around 65% GDP. U.S. public and private equity markets are, however, still, twice the size of its European's pairs<sup>38</sup> and U.S. public equity represents precisely 138% of GDP as noted by *Bavoso Vincenzo, 2017*, who also relate the debt securities connection between E.U. and U.S. on a 12.9% and 40.7% correspondently.<sup>39</sup> Also, the market values of equity, corporate bonds, and securitization across Europe represent respectively 60%, 35% and 20% of the U.S. market.<sup>40</sup>

Today, we have a growth in debt securities to 10% and Capital Market in the E.U. represent around 160% GDP whereas in the U.S. it represents 300%.<sup>41</sup>

---

<sup>37</sup> ECMI Statistical Package, 2018, *op. cit.*

<sup>38</sup> European Commission, 2015, Green Paper *op. cit.*, 7-8.

<sup>39</sup> Bavoso Vincenzo, 2017, Capital Markets, Debt Finance and the E.U. Capital Markets Union, a Law and Finance Critique, ECMI Institute, 5.

<sup>40</sup> Anderson, N., *et al.*, 2015, A European Capital Markets Union: implications for growth and stability, Bank of England Financial Stability Report n°. 33, 6-7.

<sup>41</sup> European Commission contribution to the European Council, 2019, *op. cit.*, 3.

Bank lending is thus the default option due to the bank-based dominant structure we have in Europe. Member states are, as mentioned, subject to the same monetary policy and same currency which means they respond to similar legal and regulatory frameworks, consequently, their financial markets are significantly interconnected, as we've seen, and that's precisely why bank lending to corporates and households in euro area countries may be driven through diver's systematic risk factors, representing a handicap.

Alternative resources to funding in Europe as it was the case of capital markets were until very recently fragmented across the countrywide borders and only now the E.U. seems to have reached the understanding of an integrated market-based system with alternatives is need and urgent and is trying to catch up with the U.S..

To do so, we need to be aware on regard of the macroeconomic circumstances, that market liquidity and interest rates can operate as a pressure factor since bank lending is more volatile and pro-cyclical than bond financing, particularly during financial crises, during the dry-up of financial market liquidity bank lending truly affected the financial system.

Companies in the U.S., as seen, choose to promote capital markets, issuing equity and corporate bonds. We also can see the existence of a credit risk free asset with a benchmark interest rate facilitating the origin of the best price according to all other fixed income products.

The U.S. market-based reality was definitely one of the reasons that contributed to the U.S. recovery from the financial crisis once they had a viable alternative to financing ready to be addressed on the shortfall. We also need to consider that the U.S. development on market-based economy was also pushed through the development of a private pension system where it was created a large group of institutional investors including a huge role of investment advisors and a deep corporate bond market U.S. financial system reality is a very important case study for the C.M.U..<sup>42</sup>

A number of studies, specifically published post-2008 have put great emphasis on the role that capital markets can play in an economic system, in particular with respect to their major characteristic in facilitating capital raising and investing, risk management and price discovery.<sup>43</sup>

The access to the capital markets in Europe is now, theoretically, facilitated through the C.M.U., should now be less difficult for companies to enter and raise capital on public markets however its necessary to start truly exploring its effectiveness or we will continue to assist to this corporate funding bank-based behavior.

---

<sup>42</sup> Commission's staff working document, 2015, 11.

<sup>43</sup> European Commission, 2015, Green Paper, *op. cit.*, 4-5.

## Chapter Five

### Bank-based or Market-based finance

The finance doctrine maintains huge debates on regard of bank-based and market-based financing in search to the answer of which one of the two models better result on economic growth and in the allocation of risk. As we've seen, we are dealing with super diverse realities and a way a country respond to some stimuli isn't necessarily the same way the neighbor will do so, *Franklin Allen et al., (2000)* argue that comparing models is a too simplistic approach for such complex matter <sup>44</sup> and I totally agree. We should treat what is different respecting and acknowledging the differences, working to maintain the identity of each reality. The only thing we can do with such differences is to understand them, compare them and take lessons from it, always working to provide better alternatives for similar needs.

Providing alternatives is, in my opinion, the last demonstration of respect to differences and acknowledgment of our own reality.

We already know that a bank-based structure provides, in its way, a contribution to economic growth once banks have always been specialists at mitigating asymmetric information issues among lenders and borrowers which is vital for the firms that do not have an established tracked record as creditworthy borrowers. To engage in these costly information-based activities incentives are needed and when comparing to what happens with the capital markets what we may see is that those who participate in the capital markets do not have the same incentives due to the free-riding of the other market participants which would largely prevent them from appropriating the advantages of screening and monitoring. <sup>45</sup> This mitigation of asymmetric information provided by a bank-based market reduce the moral hazard through the monitorization of its firms' <sup>46</sup> and it's still able to provide loans on it's terms to the SME's that usually do not have any access to capital markets due to their humble size.

On contrary, through the capital markets as we've seen, firms without a historic may have a chance to obtain direct funding from investors. We can perfectly see the advantages of each funding system when acting individually.

---

<sup>44</sup> Allen Franklin and Gale Douglas, 2000, *op. cit.*.

<sup>45</sup> Diamond Douglas, 1991, Monitoring and reputation: the choice between bank loans and directly placed debt, *Journal of Political Economy*.

<sup>46</sup> Boot, Arnoud, 2000, Relationship banking: What do we know? *Journal of Financial Intermediation*.

Also, banks usually better protect confidential information regarding their clients' business plans which can be very valuable on regard of competitive advantages <sup>47</sup> alternatively, capital markets tend to be great financiers of innovation once they believe in the expected value of new projects and ideas. As stated by *Robert G. King et al. (1993)* countries with better functioning financial systems tend to better address evaluating technological innovation and consequently provide an optimal alternative to its entrepreneurs which means they will allocate savings in a much efficient way. Better allocation translates in last resort to increased productivity and growth. <sup>48</sup> On the same page, we have *Franklin Allen (1993)* stating that market-based countries are those where technological innovations tend to occur. <sup>49</sup>

The question arises when we see the picture as a whole seeing the disadvantages of a non-balanced dependence to one system against the other. By means of example, the already mentioned systemic risk-taking. Bank-based systems maintain characteristics such as size and leverage that may change over time, also, while asset prices rise what usually happens against a background of abundant funding liquidity banks' expand their credit at the expense of credit quality. They literally low their standards which means that as credit creation increases and are likely to finance unstable, risky and unprofitable borrowers. When we have a situation where many banks engage in such behavior, their excessive risk-taking will generate serious systemic consequences. On the way around when prices drop, banks deleverage leading to sales of assets and widespread defaults resulting in economy-wide contagion.

The sensitivity of the economic activity to financial shocks is also bigger in bank-based financial structures, Europe's bank-based structure has considerable sizable adverse economic implications which is precisely why we say Europe's financial structure suffer from what is called a bank-bias which means the social costs of excessive reliance on banks.

Capital markets offer thus the hypothesis of issuing corporate bonds as an alternative to the bank loans, an external financing competition, providing to the individuals the possibility to move their deposits at banks to claims well-managed by institutional investors which are investing into securities traded on capital markets. The increasing share of institutional

---

<sup>47</sup> Oved, Yosha, 1995, Information disclosure costs and the choice of financing source, *Journal of Financial Intermediation*.

<sup>48</sup> King G. Robert and Levine Ross, 1993, Stock markets and resource allocation. In: *Capital Markets and Financial Intermediation*, Colin Mayer and Xavier Vives, Cambridge University Press. 159-160.

<sup>49</sup> Allen Franklin, 1993, Stock markets and resource allocation. In: *Capital Markets and Financial Intermediation*, Colin Mayer and Xavier Vives, Cambridge University Press. 102.

investors increases the demand for marketable instruments, which includes equity and debt securities.<sup>50</sup>

Both models are able to offer complemented combination of assets of finance reflecting the possibility for debtors to choose their bank-intermediated products or disintermediated marketplace-primarily based products, a perfect balance among these mechanisms is perfectly possible to reach.

By means of example, when regarding loans and bond funding, why not using them as a compliment? Offering firms, the opportunity to optimize and mix the available instruments.

Having banks as one and only source is not a good option, banks got us by the neck, obviously, they are loaded with money, they must give loans. A good structured business, of course, uses the banks, they have the monopoly, there are very banks and the only competition that exists is among them.

I truly believe that much of the difficulties would be overcome if we were able to at least reduce the level of dependence Europe's have on one of the current based-models.

Of course, we need to have in consideration that today going to the capital markets still takes a lot of money, the rules are still not that simple to attend to and the compliance costs are huge but we need to continue to look for new better methods and initiatives to adjust it to our reality. If the corporate tissue of the European Union are the SME's we need to focus on what these SME's need and can be done to provide them the alternative they need.

As part of the C.M.U project, the U.E. launched in 2017 a new prospectus regulation<sup>51</sup> improving the already existing regime which the majority of the provisions will come into force in July 2019. The first rules on prospectus appear in 2003 with a major revision in 2010, these rules ensured already the same disclosure background to all member states so investors can benefit from harmonized information valid through all Europe, facilitating transactions at a global scale.

This new regime intended to make it easier and less costly for the SME's to raise funds from the capital markets in the E.U. offering a lighter regime with less complex and more flexible requirements fitting the prospectus reality to the full start-up and SME's cycle.

Reduce the prospectus requirements, waiving them is not an easy job. How would we invest in companies we know nothing about? Especially when remembering SME's represent, like it or not, a higher risk when compared to large issuers. The market is transparent to the

---

<sup>50</sup> Schoemaker, Dirk, 2015, From Banking Union to Capital Markets Union In. A. Dombret and P. S. Kenadjian, The European Capital Markets Union: A viable concept and a real goal? De Gruyter, Berlin.

<sup>51</sup> Regulation 2017/1129.

extent that investors have access to the information they need to make their decisions. The information proves to be the most important asset for the functioning of the capital market, given that not only the investors are beneficiaries of an adequate information policy, but also the value of the issuing companies is increased through the policies of transparency. The new prospectus regulation besides all the difficulties started by exempting entrepreneurs from presenting it when raising small amounts of capital and launched a tailored disclosure regime that help the SME's to comply without the obligation of attending to the full requirements which are naturally disproportional to these kinds of companies.

This is a good time to start discussing and developing ways on how this could actually work, we are now more than ready to see and allow the value added of both chains.<sup>52</sup> Need to start contributing more actively.

I support the idea that modern financial markets would better result if these two channels of finance were combined<sup>53</sup> the identity of each jurisdiction must always be fully respected and by identity I mean the size of the companies, the corporate model and the cultural and governmental aspect, of course, since in some circumstances banks may be the optimal way to provide financing and in others, capital markets may be the answer.

Companies and individuals have, already, both mechanisms available, all we need to do now is start walking in the direction of this dual system in order to allow an optimal composition among financial instruments, offering individuals suitable new options.

Europe seems to be already in a transition from bank primarily based to a more market-based financing at least we cannot say that the conscious is not there yet by now it should be clear that even if we are still struggling with this all new possibilities at least we are already aware and conscious of its need and that is the first step to any change.

---

<sup>52</sup> Claessens, S., 2016, The future of the international monetary and financial architecture, Regulation and structural change in financial systems: ECB Forum on Central Banking.

<sup>53</sup> Davis, E. Philip, 2001, *op. cit.*.

## Chapter Six

### Challenges for the future of the financial system and next steps

The efficient functioning of the financial system requires, as noted, trust on the agents and in the operating institutions, once, as we know, any of the financial crises over the centuries had their genesis precisely in lack of confidence in the system, consequently, the existence of an adequate, efficient and clear financial regulation such as central banks or supervisory committees.

Financial regulation will also always imply governmental supervision, after all, banks borrow from a huge pool of unsophisticated and dispersed depositors, creating risk-shifting incentives for its managers and shareholders and that's precisely why banks need to be supervised, monitored in order to constantly verify its levels of exposure to risk.

There have been periods of time in which the competences of these regulators have been strongly reinforced in a way of trying to ensure the stability of the financial system, while in others we assisted to a reduction on that regulation in order to ease development of markets.

Before the 2008 crisis, the regulation was ample, liquidity management was neglected even at the regulatory level while the capital adequacy requirements were pushed down and poor risk management was also pointed out especially in securitization.<sup>54</sup> Functional supervision was likewise less effective as product boundaries become less well defined: securitization and the increase of growth of derivatives suggests risks may be unbundled and trapped, weakening the distinction between equity, debt and loans and the companies which supply them.

After the crisis financial regulation at the national and supranational level became necessary once it is one of the essential elements of the proper functioning of the markets. Today, although regulation remains domestic, the ECB is, as we've seen, a central supervisor under domestic supervision and that's why we have directives and regulation.

Strengthen the supervision and restricting the granting of credit both in Europe and in the U.S. led to a major change in the way the authorities regulate their financial systems in order to solve immediate situations of lack of liquidity in various segments of the financial system.

Trying to stabilize the financial market, reforms started to be made. In Europe, besides the already mentioned SSM and SRM supervisory mechanisms to ensure adequate supervision were created as it is the case of the European Systemic Risk Board "ESRB" that was established

---

<sup>54</sup> Dalhuisen, Jan H., 2018, *op. cit.*, 564.

as an independent European body responsible for overseeing the macro-prudential supervision of the financial system in order to prevent a resurgence of systemic risks and avoid new generalized situations of financial destabilization. The European Banking Authority "EBA" which has the powers to provide a fair framework for the various actors and to strengthen the coordination of international supervision, advising European Institutions in banking, payments, regulation, auditing and financial areas; the European Insurance and Occupational Pensions Authority "EIOPA" which ensures the transparency of financial markets and products and protects the rights of the holders of insurance policies and beneficiaries of the penny funds and the European Securities and Markets Authority "ESMA" to ensure the stability, the transparency and efficiency of the operations in the capital market having also the function of investor protection and the register and supervision of the rating agencies in the U.E.

New regulation for financial systems initiatives are extremely relevant due to the chance of contagion among financial institutions given the strong links between them; the need to ensure consumer protection which is a major concern for banking regulation causing consumers to not dispose of the information they need to protect themselves, and, in case of banks, to ensure that the financial intermediation process function properly with the respective liabilities being means of payment of the economy.

We can say a financial system is stable if we can observe it's ability to efficiently transfer resources from the agents that save to the agents that invest. The eventual flaws in financial regulation allow the financial markets to approximate to some extent to the *Hyman Minsky's* theory of financial instability.<sup>55</sup> Financial risks must be properly valued, and their cost well allocated and equally well managed; the financial system must also have the capacity and conditions to absorb financial shocks as well as shocks from economic activity.<sup>56</sup>

For more than for political reasons, banking supervision has historically been less effective in Europe than in the U.S.. European governments have been the crib of a banking nationalism way of living.<sup>57</sup> Probably precisely due to this extreme dependence on regulation what we actually assisted was the U.S. recovering much faster than the E.U. from the crisis.

It's urgent to introduce alternative financing mechanisms, new investment and funding opportunities allowing in a much more complete and accessible capital markets reality either via equity instruments or through debt instruments. Especially when considering start-ups and

---

<sup>55</sup> Hyman P. Minsky, 1992, The Financial Instability Hypothesis, The Jerome Levy Economics Institute Working Paper n°. 74.

<sup>56</sup> European Central Bank, 2011, Financial Stability Review, December.

<sup>57</sup> Véron, Nicolas, 2013, Banking nationalism and the European crisis, Bruegel.

SME's facing serious difficulties in accessing the traditional means of financing, facing refusal after refusal of credit, especially from banks which still are SME's primary option of funding after friends and families. These difficulties stem, of course, from the incipience of its balance sheets and credit history, which can't give them the needed credit scoring and often resulting in the absence of enough financial flows depending on which stage of creation they are. The credit contraction following the financial crisis of 2008 certainly has a huge role on this but is still the today's reality believe it or not. Solutions are urgently needed.

An alternative, when considering start-ups besides giving up the business, would be to be financed through professional investors such as business angels which occur at a 29% or venture capital funds and companies, at a 26,3% the main players in private equity. New measures to support these venture capital and equity funding are also part of the C.M.U project. We have still a funding gap of incipient companies that do not have dimensions to evolve themselves in such sources of financing and of operators wanting to meet the financing needs of this type of riskier project, which is, most of the times, the case when discussing start-ups since their initial capital requirement is usually much higher than the SME's.<sup>58</sup> They are disruptors who seek to fill this void left by banks and investors doing a bridge funding, is a new market within the existing market.

The today's new era of the new technologies definitely contributes to a better connection among markets, new methods of financing are taking advantage of the possibilities offered by this technological innovations and by this gaps reshaping the financial system as we know it with a cost-efficiency outcome more favorable through the high frequency trading platforms, the FinTech.<sup>59</sup>

Alternative means of online financing appear as an alternative such as the already mentioned crowdfunding, by means of example, where there is a subscription of social participation online and through it the natural sharing of profits and dividends or loan remuneration.<sup>60</sup>

The FinTech are able to provide direct cheaper way of funding especially for our SME's, yes, but they also represent a not so consistent and safe area of business, at least for now, since its participants are highly diversified being able to be qualified investors or not, being in most of the cases investors exclusively motivated by social and psychological factors.

---

<sup>58</sup> European Commission, 2018, Annual Report on European SME's, *op.cit.*, 51.

<sup>59</sup> European Commission, 2015, Green Paper, *op. cit.* 26.

<sup>60</sup> European Commission, Digital Single Market Report, 2015, 5.

Crowdfunding started to have its own regulatory issues these days which opened space for other alternatives as it is the case of the Initial Coin Offerings "I.C.O's" that involve the financing by the subscription of *tokens* emitted on the technological infrastructure of cryptocurrencies as the bitcoin through the blockchain by means of example. Blockchain technology has enormous potential to reduce transactional costs associated with financing.

I.C.O's, however innovative, are only just a new, refreshed face for the problem hereby discussed, the need for finance of newly launched projects. In this case through an appeal to the public for the transfer of funds in exchange for a title that grants the investor certain rights related to the project. They offer a lower cost and take away the need for financial intermediaries allowing startups to access liquidity that otherwise considering the actual options we have on the market they couldn't.

This is, however, a two sides coin, literally. It is good to bear in mind that the Fintech are the ones directly challenging the banking system and not properly worried in complementing it, on contrary of what we assist in the C.M.U., they also represent an aggressive way of answering this poor and inadequate huge dependence on the banking system which is directly linked to my crave to reach a solution, a middle way solution, urgently.

Still on the Fintech, as good as they might be and they are, we must remember that we are talking about a complete dematerialization of the operation, which, personally, I'm all in but we must be very careful to the information asymmetry; exposure to hacking; the eventual incentive to pyramid schemes and speculative bubbles such as the cryptocurrencies beyond the still abroad legal uncertainty which will certainly drive away more conservative investors looking for safer environments and attracting less well-intentioned operators once in this reality they can still act without any major constraints.

I do not mean to discard that, within markets, it may be concluded that, yes, the Fintech may be the way, the middle way I'm looking for. I think it may be very possible and I totally support all new methods that provide us open ways instead of the old, conservative already exhausted doors but, today, without substantial regulation in this scenario, it seems to me farther to be reached than the adjustment in the traditional market access requirements. I hereby suggest us to focus on root the capital markets granting, at least, that we have explored all its potentialities.

Today, my especial attention stays on the development of this Capital Market Union and the all range of possible outcomes we can still try to achieve from it.

## Conclusion

We are now aware why we have such a huge mismatch between bank-based systems as the European and market-based system as the American. We are also aware the E.U. recognized the need to change the current scenario and started to implement measures aiming to reach a more balanced model.

First of all, as previously mentioned, we should always be very careful with the comparison between the E.U. and the U.S. since, as we know, the U.S. has many large and many more quoted companies due to their corporate culture and dimension. The market mechanism is more trusted around there since they accept the *boom and bust* culture and we do not.

In Europe we believe in administrative mechanisms to provide stability to society, we are less entrepreneurial, we have fewer companies, fewer large companies but several small companies that are small because they want to and they succeed handling smallness which is obviously a cultural tendency and there is nothing wrong about it.

Secondly, as previously mentioned we need to recognize and honor our corporate tissue, embracing it and making it work the best way possible, it is what characterizes our reality, it's part of our European personality and fingertip.

While recognizing the cultural and corporate mechanisms each force made use, I still insist the E.U. need alternatives to explore its own potentialities, even when considering the new leaks, through the Fintech the SME's may found today, I truly believe we can embrace the already existing capital market structure and adapt it, adjust it to our needs embracing the characteristics of our individuals and their businesses.

Once we understand the relevance of the new start-ups and SME's for our present and even our future, how they hugely contribute to the development of technological, energetic, robotic, artificial intelligence innovation and allow us literally to advance in time which ultimately will benefit us all, why underestimate it and deliver it to other, still poor, ways of financing not so raised in the already existing market structures? Why not create the conditions to do so? This is a new era and as new as it is need to be recognized and esteemed.

The C.M.U. is, we must recognize, a very good start to combat this mismatch once it precisely recognizes we have several SME's that need proper attention, as so, many individuals interested on investing, gaining, both of them, access to meet on the capital markets.

The C.M.U. provides us with an attempt to an option on the banking system, introducing several new ways to better explore and take good benefit from the capital markets. It gives us

the freedom to invest, we can now freely invest in the Eurobond markets, as so in the domestic market, all the prospectus and requirements rules are harmonized, and we have full access to it.

I said is a start since we still have major work to do, once, in order to successfully achieve this true union current impediments to access capital markets must still be reduced.

We have a huge diversity of measures that turn out to be conflicting, confusing and may even overlapped which contribute to the maintenance of an uncertainty atmosphere which may compromise the internal order of the C.M.U. and its ideal external reflection, consequently, the equilibrium among alternatives we intend to reach.

As noticed, psychological and behavioral factors play an important role within the way wherein banks or rather individuals who take investment decisions allocate their resources since they will always rely on their perception of the state of the economy at that given time. As their feelings are optimistic and they feel supported its likely they choose to allocate resources to the alternative system if not, they will continue to invest in the traditional conservative methods they are already used to.<sup>61</sup> This bias clearly hinders optimal welfare investments.<sup>62</sup> Also, the lack of information or, if you prefer, the range of multiple, disperse, unrelated information is in my opinion a major issue, to not say flaw, to overcome.

On a daily basis, we found several disperse information provided from most divers' institutions in Europe usually on the same alternatives and using too many technical terms which is equal to absolutely nothing to the common investor. We need to be able to provide clear, simple information material to attract new potential investors. The information must be absolutely clear and not repeated. Less is more.

The C.M.U have also a fundamental pillar missing in it's whole system of proposals and new initiatives, a consistent, focused and clear action concerning investor protection, similar to what already happened in the banking union, allowing, through it, the investor to feel confident and secure in case of a disaster. We won't even need to cover all the financial instruments nor all the periods of investment, clever solutions may be reached in the mid-way. The absence of implementation of solid and secure investor compensation schemes is, undoubtedly another constraint to be overcome.

Another issue I've noticed through investment platforms here in Europe which was also reported to the Commission<sup>63</sup> were the excessively high fees that are being applied which will

---

<sup>61</sup> Bhattacharya Sudipto *et al.*, 2011, Minsky's Financial Instability Hypothesis and the Leverage Cycle, LSE financial markets group paper series, 22-33.

<sup>62</sup> Avgouleas Emiliios, Cullen Jay, 2015 Excessive Leverage and Bankers Pay: Governance and Financial Stability Costs of a Symbiotic Relationship, Columbia Journal of European Law, 5-7.

<sup>63</sup> Commission Staff Working Document, 2017, 10-11.

discourage, once again, the new potential investor. We need to attract investors, the more, the best once we will start to incentive these investors to come to the market and consequently more funds will arise increasing all the structures, fortifying it. Due to this scenario its natural that the new potential investor is still not confident to do so and that's why we are still attached to the bank-based reality. If the U.E. is not worried in provide to its investors the needed information and safety feeling to change their habits why would them?

There are other factors I firmly believe deserve the warning call and need to be adjusted as it is the case of cultural diversification we face in Europe regarding, especially, the technical and non-technical language and the accounting, tax and legal systems which may not being receive the proper attention contributing to an actual possibility of overlapping between the legal systems.

Also, the fact that markets and economies are not all at the same tier of development which means the impacts will feel hugely different in each reality, least prepared countries must benefit from technical assistance to better adjust their regulatory framework for further improvement. The C.M.U need to find its way to show to the member states total respect and good faith during the negotiations once these national specificities are natural barriers to the internal market. Recalling that one of the vital factors on which the European Union is founded is the principle of subsidiarity between the Union and its institutions remembering that the area of financial services is also based on building and deepening the internal market and free movement of capital which means member states may at any time claim that their national systems work well and no joint action is needed. This is a very subtle area that must be managed with warily, we must make sure those markets are receiving the adequate treatment if not, this would represent a huge flaw in the future of the C.M.U..

The success of the C.M.U. entails a deep shift, asks for the unwinding of a deep-rooted scenario so flexibility is the only way to achieve a truly integration and harmonization among the member states. It's not going to be simple, but we need to start moving faster.

A well-balanced composition between the banking system and markets of capital would allow us to better benefit from the effects of the stability of the financial system as a whole exploiting the advantages of their complementarity. It's definitely better to have a plurality of channels financing the real economy than to rely on just one as it should be clear by now.

Some doubts insist to remain, however, can we say that there has been at least until the creation of the C.M.U. some incentive to not compromise or create alternatives to the banking channel? Maybe. At what point is the success of the C.M.U. previously conditioned to the already existent alliances in such a conservative already entirely dominated and well-known

system as the banking one? The truth is that the financial instruments to do so has always been and still are at disposal. During this process of implementing the C.M.U., as exposed, we're actually facing some unnecessary, almost basic difficulties that make no especial sense at this stage of the process, as it is the case of the disperse information or high fees when the idea is precisely to attract and not repeal investors, which raise me the question if there is a real interest from the Union in developing Capital Markets or not.

Through this exposition I believe to have found some elements that may lead us to the idea that a middle way between market-based and bank-based may be the solution, at least for now, we've been providing banks to much control to almost govern us, our ideas and ways of businesses giving them the status of being the only option available and, on the other hand, humbling understanding that we still have a long way to reach a new model of access through the Capital Markets that faces the European reality and true needs.

In my personal opinion, is more than time to gain conscious about what is really happening and of all the ramifications and possible outcomes of this discussion, especially, considering how it affects us as individuals, us as companies and us as countries and union.

The existence of different complementary sources of financing constitutes an important stimulus for innovation, entrepreneurship, research, and development of new business models. It's time for us, to start monitoring and speak out loud about the accomplishment or not of these new measures and projects. The world is changing at a super-fast pace, it's not reasonable to take so much time, documents and a wild range of disperse information to adopt new, better, alternative measures that will only benefit those who want to invest and those who want to grow their companies creating jobs and promoting the economy contributing to innovation.

Remembering, it is not an imposition or a substitution, is an alternative and everyone benefits from viable, truth, alternatives.

## References:

**Allen Franklin, 1993**, Stock markets and resource allocation. In: Capital Markets and Financial Intermediation, Colin Mayer and Xavier Vives, Cambridge University Press.

**Allen Franklin and Gale Douglas, 2000**, Comparing Financial Systems, MIT Press.

**Allen Franklin and Gale Douglas, 2007**, An introduction to financial crisis, University of Pennsylvania.

**Anderson, N., Brooke, M., Hume, M., and M. Kurtosiova, 2015**, A European Capital Markets Union: implications for growth and stability, Bank of England Financial Stability Report n°. 33.

**Avgouleas Emilios, Cullen Jay, 2015**, Excessive Leverage and Bankers Pay: Governance and Financial Stability Costs of a Symbiotic Relationship, Columbia Journal of European Law.

**Bavoso Vincenzo, 2017**, Capital Markets, Debt Finance and the E.U. Capital Markets Union, a Law and Finance Critique, ECMI Institute.

**Biondi, Yuri, 2016**, Empowering Market-Based Finance: A Note on Bank Bailouts in the Aftermath of the North Atlantic Financial Crisis of 2007.

**Bhattacharya S., Goodhart C., Tsomocos D., Vardoulakis A., 2011**, Minsky's Financial Instability Hypothesis and the Leverage Cycle, LSE financial markets group paper series.

**Boot, Arnoud, 2000**, Relationship banking: What do we know? Journal of Financial Intermediation.

**Bouyon Sylvain, Pietro Gagliardi, 2018**, Lending to Households and non-financial corporations: growth and trends in 2017, ECRI Statistical Package 2018.

**Claessens, S., 2016**, The future of the international monetary and financial architecture, Regulation and structural change in financial systems: ECB Forum on Central Banking.

**Commission's staff working document, 2015**, Initial reflections on the obstacles to the development of deep and integrated EU capital markets.

**Commission's staff working document, 2017**, Feedback Statement for the Public Consultation on the Capital Markets Union MidTerm Review.

**Committee on the Global Financial System, 2018**, Structural changes in banking after the crisis.

**Davis, E. Philip, 2001**, Multiple Avenues of Intermediation, Corporate Finance and Financial Stability, International Monetary Fund, IMF, Working Paper n° 115.

**Dale, Richard, Bruni, France and Boissieu, Christian., 2000**, Strengthening Financial Infrastructure. Deposit Insurance and Lending of Last Resort, Société Universitaire Européenne de Recherches Financières.

**Dalhuisen, Jan H., 2018**, Dalhuisen on Transnational Comparative, Commercial, Financial and Trade Law, Volume 3.

**Dewatripont Mathias, Nguyen Gregory, Praet Peter and Sapir André, 2010**, The role of state aid control in improving bank resolution in Europe, Bruegel Policy Contribution.

**Diamond, Douglas, 1991**, Monitoring and reputation: the choice between bank loans and directly placed debt, Journal of Political Economy.

**Draghi Mario, 2019**, Introductory Statement, President ECB at the ECON Committee of the European Parliament.

**ECMI Statistical Package, 2018.**

**European Central Bank, 2011**, Financial Stability Review, December.

**European Central Bank, 2011**, The new EU framework for financial crisis management and resolution, Monthly Bulletin, July.

**European Central Bank, 2018**, Financial integration in Europe, Chapter 1: Financial integration in the euro area: recent developments.

**European Commission Communication, 2010**, An E.U. Framework for Crisis Management in the Financial Sector.

**European Commission, 2015**, Building a Capital Markets Union, Green Paper, COM2015/63.

**European Commission communication, 2015**, Action plan on building a Capital Markets Union.

**European Commission communication, 2016**, Capital Markets Union - Accelerating reform.

**European Commission contribution to the European Council, 2019**, Capital Market's Union: progress on building a single market for capital for a strong Economic and Monetary Union.

**European Commission, Digital Single Market Report, 2015**, Crowdfunding innovative ventures in Europe: The financial ecosystem and regulatory landscape.

**European Commission, 2018**, Annual Report on European SME's, SME's growing beyond borders.

**European semester thematic factsheet, 2017**, Small and Medium-Sized enterprises access to finance.

**Fonteyne Wim, Bossu Wouter, Cortavarria-Checkley Luis, Giustiniani Alessandro, Gullo Alessandro, Hardy Daniel, and Kerr Seán, 2010**, Crisis Management and Resolution for a European Banking System, IMF Working Papers.

**Hyman P. Minsky, 1992**, The Financial Instability Hypothesis, The Jerome Levy Economics Institute Working Paper n°. 74.

**King G. Robert and Levine Ross, 1993**, Stock markets and resource allocation. In: Capital Markets and Financial Intermediation, Colin Mayer and Xavier Vives, Cambridge University Press.

**Kono, Masamichi and Schuknecht, Ludger, 1999**, Financial services trade, capital flows, and financial stability, WTO Staff Working Papers, World Trade Organization, WTO, Economic Research and Statistics Division, Geneva.

**Langfield, Sam and Marco Pagano, 2016**, bank bias in Europe: effects on systemic risk and growth, Economic Policy.

**Oved, Yosha, 1995**, Information disclosure costs and the choice of financing source, Journal of Financial Intermediation.

**Piketty, Thomas and Gabriel Zucman, 2014**, Capital is back: Wealth-income ratios in rich countries, Quarterly journal of economics.

**Schoenmaker, Dirk., 2015**, From Banking Union to Capital Markets Union In. A. Dombret and P. S. Kenadjian, The European Capital Markets Union: A viable concept and a real goal? De Gruyter, Berlin.

**Shoenmaker Dirk and Darvos Zsolt, 2018**, Institutional Investors and development of Europe's Capital Markets, Chapter 18 in Busch Danny; Avgouleas Emilios; and Ferrarini Guido, Capital Markets Union in Europe, Oxford University Press.

**Sørensen, Brent E. and Oved Yosha, 1998**, International risk sharing and European monetary unification, Journal of International Economics and Darvas, Zsolt and Schoenmaker, Dirk, 2017, Institutional investors and home bias in Europe's Capital Markets Union. Bruegel Working Paper.

**Tartullo, Daniel K., 2016**, Financial Regulation since the crisis, speech.

**Véron, Nicolas, 2013**, Banking nationalism and the European crisis, Bruegel.

**Véron, Nicolas and Guntram B. Wolff, 2015**, Capital Markets Union: a vision for the long term, Policy Contribution 2015/05, Bruegel.

#### **Legislation:**

**Directive 2014/49/EU** on deposit guarantee schemes.

**Regulation 2017/825** on the establishment of the Structural Reform Support Programme for the period 2017 to 2020.

**Regulation 2017/1129** on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.