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Capital markets: open or closed?

Whether capital markets work best – most efficiently, effectively and safely – if they are open or closed is a long-standing policy debate. The high volatility seen in the early stages of the spread of COVID-19 has re-opened that debate yet again. The full economic impacts of the pandemic are not yet fully understood, but it is certain that businesses of all sorts will need to tackle debt burdens not seen on such a scale before.

The crisis has also highlighted that all business sectors are deeply interconnected across borders and that economies of all types and sizes are vulnerable. Financing channels – in particular, the capital markets – need to reflect this reality in order to help support recovery. Achieving sustainability goals, both environmental and social, will require additional and large levels of private funding.

In the face of such extraordinary circumstances, it is understandable that some temporary measures were introduced to protect capital markets and sovereign debt. They should be temporary. The building of more permanent protective walls around economies, including limiting access to national financial markets, must be avoided.

History has shown us time and time again that closed capital markets damage the very economies that officials are trying to protect. I sincerely hope that the debate within the EU will not be as stark as open or closed, but about whether access should be limited in anyway and the optimal degree of regulation.

In the retail markets, a greater degree of regulatory protection is understandable and necessary. In the wholesale capital markets, while customer protection should not be forgotten, the focus should be on financial stability, market integrity, fair competition and the prevention of regulatory arbitrage. To achieve this, there needs to be a commitment to developing deep constructive relationships with third-country regulators, including dialogue on enhancing supervision and coordination.

Clearing, for example, is a global business and is key to financial stability in the capital markets. Both globally and in the EU, the regulation around the recovery and resolution of clearing houses is consistently developing. The intention is that all market participants can plan for and will know how to act if a clearing house becomes distressed or starts to fail. Regulators are encouraged to work closely together in their supervision of clearing houses through regulatory colleges and crisis management groups, sharing information and helping ensure a smooth system. Strong regulatory cooperation is essential. To be truly effective it requires trust on both sides.

Access to EU markets largely falls under equivalence provisions. The equivalence process is meant to be outcome-based: assessments should be determined not only by reference to the content of law and regulation, but also considering the approaches of the respective parties to supervision and enforcement.

Line-by-line analyses of a third country's rules can miss the point and, potentially, limit market access, adversely impacting EU economies, businesses and citizens. Barriers to capital markets will result in European corporates having less access to liquidity and choice, and potentially higher cost of financing, which will be a cost to the overall finance system.

This underlines the importance of regulatory dialogue and coordination. It requires a framework for strengthening the processes for granting and withdrawing access to and rights within the EU markets.

It should ensure greater legal and regulatory certainty, while protecting regulatory autonomy. It is also paramount that central banks and banking regulators co-ordinate actions to ensure they do not inadvertently jeopardise systemically important, global FMIs.

Regardless of the outcome of the negotiations between the EU and the UK, and ongoing discussions with other key third countries, I would urge the EU to make a strong commitment to open and well-regulated global capital markets, in words and in action. ●