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# Keynote speech
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## Introduction

Let me begin by thanking Bloomberg for their kind invitation to participate in the opening session of the Bloomberg Capital Markets Forum Madrid.

In my address I shall refer firstly to the phenomenon of banking disintermediation in Spain in the European context, discussing the main implications. And secondly, I shall focus on the importance of the Capital Markets Union project as a private risk mitigation and sharing mechanism in the Economic and Monetary Union (EMU) which, in conjunction with the Banking Union, will provide for an increase in financial stability in the euro area.

## Banking disintermediation in Europe and in Spain

As is well known, in the continental European countries banks have traditionally played a key role in the intermediation of economies' financial flows. However, recent years have seen an increase in European firms' preference for tapping capital markets.

Fixed-income financing has thus risen from accounting for 8% of European firms' total financial debt at end-2007 to 12% in the third quarter of 2018.

Spain has been no stranger to these global trends of banking disintermediation. Indeed, the proportion of fixed-income securities relative to the business sector's financial debt has risen over the same period by 10 percentage points (pp). This has been mirrored by a fall, since 2010, of 9 pp in banks' weight in the total financial assets of the financial sector.

This gradual increase in business financing on the capital markets by means of the issuance of fixed-income securities is due to a series of factors, some transitory and others more structural in nature.

Notable among the transitory factors common to all Euro area countries was the introduction in 2016 of the Eurosystem's Corporate Sector Purchase Programme, which is part of the Asset Purchase Programme. This programme has contributed to boosting corporate funding through fixed-income issues, by reducing their cost relative to bank financing. In any event, analyses by Banco de España economists show that this programme also contributed indirectly to improving the access by SMEs to bank funding. This was because banks allocated a high proportion of resources freed up by the repayment of loans by securities-issuing firms to funding smaller-sized firms without access to the securities markets.

Following the end of net asset purchases, since early 2019 the Eurosystem's Asset Purchase Programme has remained active by reinvesting the amounts maturing on the securities purchased. It is thus expected that this programme will continue to be conducive to the issuance of corporate debt.

Among the more permanent factors behind the rise in capital markets in Europe are, firstly, the new international banking regulations in response to the crisis. True, the new regulatory requirements to improve banks' resilience to adverse shocks contribute to strengthening financial stability. But they might also hamper banks' ability to compete in the intermediation of some financial flows.

Secondly, the influence of the alternative fixed-income and equity markets is worth highlighting. The launch of these markets, geared to luring medium-sized firms, is also contributing to the development of the capital markets. In particular, in Spain we have witnessed the development of the alternative fixed-income market MARF. That said, their size is still small in most European countries.

In the future, this trend towards the greater development of capital markets might continue if progress is made on the European project to create a Capital Markets Union, as I shall later discuss.

A further factor pointing in this same direction is the potential increase in long-term saving associated with population ageing. The reason is that, for this investment horizon, capital markets may be a comparatively more attractive option than in the case of short-term saving.

Moreover, technological progress might prompt an increase in the activity of new non-bank competitors with innovative technologies. So far, market penetration by this type of player in the credit-supply business is limited in most European countries. Initiatives like the regulatory sandbox currently being designed in Spain, have the objective of promoting the emergence of these type of players.

These controlled test environments aim to provide, with all due security measures for participants and the system as a whole, a nimble framework that provides for the viability testing of the new business models based on new technologies.

They will also enable the supervisory community to gain knowledge on how new business models and technologies function and the new risks associated with them. In turn, this in depth knowledge will allow supervisors to fully exploit the proportionality principle embedded in regulations for those viable projects that might finally exit the test environment.

Because we should not forget that such test environment should have a temporary nature. Hence, for those projects that prove viable, the principle of same regulation for similar activities and risks should prevail. In any event, it is currently difficult to foretell how the development of these disruptive technological players will evolve in the future.

Like any process of change, financial disintermediation will involve significant benefits for society; but it is not free from challenges for banks, for the regulator and, naturally, for the Banco de España itself, in its role as guarantor of financial stability.

Among the benefits for those demanding funds, associated with a more diversified financing structure, are, on one hand, their greater stability in the face of shocks that affect specific institutions in the financial sector.

Indeed, the international financial crisis highlighted the greater difficulties in gaining access to funding for those firms depending exclusively on bank lending, in contrast to those with a more diversified financial structure. These problems were more acute for those firms – chiefly SMEs – operating with a small number of banks more harshly affected by the crisis, since the possibilities of replacing their usual lenders with new banks was not always easy owing to asymmetrical information problems.

On the other hand, the development of non-bank funding sources may also contribute to providing readier financing for specific investment projects; for instance, those undertaken by innovative or newly created firms, for which the availability of bank lending may be more limited. It should be borne in mind that the launch of some of these projects may have a positive impact on firms' productivity growth.

Naturally, these advantages for those demanding funds may have positive effects for society as a whole, insofar as they result in higher and more stable economic growth.

From the standpoint of fund suppliers, the existence of alternative means of investing their saving may result in more attractive return/risk combinations for various savers, depending on their needs and preferences.

So that households and firms may benefit fully from all the advantages of banking disintermediation, they will need to have sufficient financial knowledge. This is something that the Banco de España, along with other bodies such as the CNMV, is firmly committed to through financial education programmes such as "Finance for all".

Evidently, disintermediation poses substantial challenges for banks. Greater competition from non-bank intermediaries may affect both banks' business volumes and net interest income. This potential loss of income is significant at the current juncture, at which banks are posting modest levels of profitability, the economy is slowing and private-sector demand for funding remains sluggish.

In response to this more competitive and challenging environment, banks could adopt various strategies such as greater income diversification, the containment of operating costs and increased investment in technology.

From the regulatory standpoint, the main challenge will involve maintaining a level playing field for all financial system participants, so that similar activities posing similar risks are subject to a comparable level of regulation.

As the supervisor of banks and guarantor of financial stability, the Banco de España also faces very important and specific challenges as a result of disintermediation.

In this new environment, the relative importance of the main risks to financial stability will foreseeably change with an increase of those linked to market risk. As a result, the supervision and analysis of the financial risks arising outside the banking system and of the interconnections between banks and other financial system participants will become more important. These interrelations will not only take the form of cross-balance sheet or income statement positions; similarities between the portfolios of different types of participants may also mean that shocks initially affecting one institution or a group of institutions may ultimately have repercussions for all other financial market participants.

In this respect, it should be borne in mind that the Banco de España is responsible for activating and deactivating certain macroprudential tools introduced under legislation to mitigate systemic risk in the financial sector. Most of these instruments are applied almost exclusively to banks. Thus, growing banking disintermediation might diminish the general effectiveness of such instruments, if other participants in the financial system, to which these tools were not applicable, were to engage in activities similar to those of banks.

To mitigate this risk, the forthcoming creation of a Spanish Macroprudential Authority will provide the appropriate forum in which all financial system supervisors may share their analysis of risks and coordinate the most suitable response, without leaving “gaps” that might restrict effectiveness

**Private risk mitigation measures in the Economic and Monetary Union**

In any event we should be mindful that, to ensure greater stability in European financial systems, it does not suffice to adopt measures at the national level; it is also necessary to push through a greater level of development and integration of European capital markets so that, in conjunction with the Banking Union, the risk-sharing and mitigation mechanisms at the level of the euro area as a whole are strengthened.

In this connection, allow me to dwell on the importance of private risk mitigation measures. The crisis highlighted the scant power of these channels in the Economic and Monetary Union, compared with other monetary unions. It also became evident that these channels diminish, or even disappear, precisely when they are most needed.

It is estimated that in the United States the cross-border ownership of capital across states enables 40% of the asymmetric shocks affecting a State to be diluted among the rest through private capital markets. However, in the euro area such dilution is only 10%, owing to a greater national bias in asset holdings.

The main private channel for risk dilution in the euro area at present is that of lending by the European banks that operate in different Member States. But this channel becomes unstable and may even shrink or disappear in situations of uncertainty owing to the link between sovereign States and their domestic banks.

As is known, capital markets in Europe are less developed and less integrated than in the United States. Corporate financing on equity markets is very limited and, moreover, shows a strong national bias.

In the United States, cross-border holdings of assets play a significant role in mitigating the shocks that affect a State. However, in Europe this mechanism is very limited.

This is why it is crucial to complete the Capital Markets Union project so as to achieve greater depth and integration of European Union capital markets. That will allow for greater risk-sharing in private euro area channels and less reliance on bank financing, which will result in greater stability in the euro area.

The aim of this project is to provide new financing sources for firms at a lower cost, and at the same time to attract more foreign investment towards the European Union. To achieve this, the European Commission proposed a plan of action in 2015 with over 30 measures to construct an integrated capital market in the European Union, to be completed by 2019. However, so far, the implementation of these measures has been slow and incomplete.

It is a far-reaching project requiring highly diverse measures, including most notably the creation of market infrastructure, the harmonisation of market regulation and supervision, and the strengthening of the European supervisory authorities.

There is also a need to move towards harmonising insolvency arrangements, both for banks and non-financial corporations, and to tackle aspects such as the bias in some countries' tax systems towards debt as opposed to equity financing.

Moreover, this project takes on particular importance in the context of the exit from the European Union of the United Kingdom, which currently plays a key role as a European financial centre.

In connection with the Capital Markets Union, some initiatives have been adopted to provide financing for those segments with scant access to bank lending. One example is the innovation projects for which the promotion of venture capital funds is being considered.

Measures have also been adopted to promote the use of simple, transparent and standardised securitisations in order to provide bank lending to small firms. These examples evidence the complementarities between bank markets and capital markets, and also how the Banking Union and the Capital Markets Union reinforce one another.

Turning to equity markets, progress has been made to provide firms with access to these markets. Further, many studies have been undertaken to identify the obstacles to international investment.

Yet, in order to equip the euro area with greater stability, resolute headway must also be made in European bank integration. Pan-European banks are an essential requirement if we are to have a single market for wholesale and retail financial services. That will provide both for gains in efficiency and cost reductions in banking services. And, moreover, it would contribute to improving the euro area's stability in the face of shocks.

In this respect, the culmination of the Banking Union with its three pillars and the subsequent creation of pan-European banks would also enable the link between sovereign risk and bank risk to be substantially mitigated.

There has been significant progress on the first two pillars, the Single Supervisory Mechanism and the Single Resolution Mechanism. But the third pillar – the creation of a European Deposit Guarantee Scheme – remains pending.

In conclusion, in Europe, and in Spain in particular, we have witnessed a phenomenon of greater disintermediation in recent years. Associated with it is a more significant role for capital markets when it comes to providing financing for the economy and channelling citizens' savings. In parallel, technological change conducive to disintermediation is under way, and is prompting the creation of new services and risks that must be addressed by the supervisory community.

To harness these market trends so as to promote the soundness and stability of Economic and Monetary Union, resolute progress must be made towards the greater European integration of banking markets, fomenting at the same time the development and integration of capital markets throughout the Union.

Thank you.