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In an interview with Vincent Wall on Newstalk's *Breakfast Business* program, ICI President and CEO Paul Schott Stevens discusses how the stance of European Union (EU) regulators, as well as the United Kingdom's departure from the European Union, may challenge efforts to create a seamless capital markets union.

Transcript

Vincent Wall, host of *Breakfast Business*: You're listening to *Breakfast Business* with Vincent Wall. An interesting man in Dublin this week: Paul Stevens, president and chief executive of the Washington-based Investment Company Institute. It represents most of the world's largest regulated fund management firms, many of them with significant operations in Dublin. They're also key players in the capital markets, channeling long-term savings of many retail investors to provide alternative sources of funding to bank lending for businesses and governments. The EU has plans to create a seamless capital markets union to stimulate this source of financing in Europe and to enable businesses [to] access it on a cross-border basis. But Paul Stevens believes these plans are now challenged by the departure of the UK from the Union and by the stance of the EU's regulators or central banks.

Paul Schott Stevens, president and CEO of ICI: You know there was some hope, a number of years ago, at the time of the Capital Markets Union initiative, that Europe would, really in a serious way, undertake to diversify the sources of financing here. From my perspective as an outsider, those hopes have largely been disappointed. I think that the prospect that Europe would renew that in a serious way is less in the absence of the United Kingdom than it would be were the UK still part of the union. There still is an attitude on many parts here, I think, for, "no risk, please." And there's, I think, a great suspicion among central bankers in Europe about nonbank financial intermediation and the risks that they hypothesize that it might pose. You know, if you look at it from our perspective in the United States, the greater risk is the lack of diversification in sources of funding. I'll be speaking in London later in the week, and I'm going to try to make people understand that there's a difference between financial stability and financial robustness.

Robustness is a condition of a system that is allowed—that permits it to—weather multiple shocks, and part of what characterizes a robust system is diversity. So the lack of diversity here in European sources of financing, I think, is really the weakness, and ought to fix the minds of European policymakers on trying to diversify those sources of financing beyond Europe's banks.

Wall: Why do you think that is? Are regulators in Europe, in particular, wary of mutual funds' other nonbank financial instruments and markets that perhaps they don't have as much control over?

Stevens: I think it's culturally based. Europe has for a very, very long time been a bank-dominated financial market. The United States, by contrast, from our very origins has depended upon different kinds of financing. Alexander Hamilton, our first secretary of the Treasury, established the market in US government securities. So, from the very beginning, we had both capital markets and bank intermediation as part of the US system, and I think that's been part of our strength.

We're very concerned when we hear central bankers here in Europe begin talking about applying macroprudential regulation to the asset management business and, in particular, open-end funds like UCITS and our mutual funds. What that essentially promises is the application of bank-type regulation on capital markets entities, which is something that has not been the case in the past. They talk about the ability to suspend redemptions, to impose liquidity buffers, and the like. We're not banks—we don't accept principal risk, we act as agents for our clients. Whatever happens with respect to the investments, the losses and gains flow through to—in the case of mutual funds—many, many millions of individual retail clients. So, the risks are dispersed throughout the system. It does not depend upon a state backstop or taxpayer interventions. We saw in the United States, for example, during the financial crisis, our

equity markets went down by fully 45 to 50 percent. And our long-term mutual funds—stock and bond funds—were among the most resilient parts of the US financial system—in fact, I would say the global financial system.

We have looked at market developments in the United States since 1940, since the birth of the modern US mutual fund industry. And you think about that period of time—the various shocks that the financial system has been subject to—we have never seen a situation where mutual fund investors stampeded out of funds, requiring fund managers to wholesale liquidate their portfolios at fire-sale prices and thereby destabilizing the financial markets as a result. Over and over again, we hear the central bankers, particularly here in Europe, predicting that that's going to happen. But it never has, and there are reasons for it. And we've provided both the data and the explanations that we believe historically have explained why this has not happened in the past—yet it hasn't quite gotten through. We're continuing to work to try to deliver that message.

Wall: You're concerned as well about, perhaps, the imposition of fee caps on what your professional investors can earn from managing these types of funds.

Stevens: In the context of the investment firms review that's being conducted here in Europe, there have been proposals for bonus caps, limits on compensation that might be provided to important executives that are managing investment funds. We understand why European policymakers want to make sure that compensation arrangements are such that they do not invite people to take risks at, potentially, the expense of their clients or of the system, if you will, and to their own benefit. We don't see those risks arising in the context of the asset management firms for lots of different reasons, and there is a potential consequence, I think, for Europe in imposing those caps that don't exist elsewhere. The investment business, at the end of the day, depends upon the talents that individuals bring to the office every day, and if they don't think that they can be rewarded at a competitive basis in one jurisdiction, it's quite easy for them to go work in another.

Wall: But do you accept that whatever about at a policy level—at a state or Europe-wide policy level—that individual investors may not be encouraged to invest in mutual funds, whether it be longer-term savings or pension funds, if they believe individual asset managers or groups of asset managers are being paid an exaggerated amount?

Stevens: There's a populist element to this, no doubt, and I think that's a large part of what is fueling the proposals for bonus caps. And I grant you that that is a concern. It is the shareholder, the individual investor's interest that ought to come first in all of this, but part of that interest is making sure you have the very best people possible that the firm can engage to work on their behalf. That is the proposition of the mutual fund industry historically—making available to ordinary investors the same quality of professional portfolio management that would be available to the wealthiest individuals in our economies. You just do it on a mutualized basis and on a mass basis.

Wall: Yeah, interesting argument. That's Paul Stevens, chief executive of the Investment Company Institute.

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