Capital markets union (CMU) is a new term but it is not a new concept in Europe. CMU describes an existing evolution of European financial market integration that started many decades ago yet probably still has many more ahead of it before a "true" or "full" union is established.

The benefits of CMU can be summed up as removing supply impediments to access to capital, defined broadly here as both savings and financial securities, i.e. making the process of matching savings with investment more efficient.

In theory the CMU already exists. Article 63 of the Treaty on the Functioning of the European Union (TFEU) allows for the free movement of capital across intra-union borders. And 19 member states share currency union.

In practice, however, we do not observe the extent of integration of European capital markets as we do in other CMUs with deeper federal structures, such as the United States. Europe has instead what I call a capital markets confederation.

The question becomes are we content with the confederation structure or do we want to develop it further? And if we want to develop it further do we want to achieve the type of features we observe in the United States with deep, liquid markets and no intra-state cross-border impediments to the movement of capital?

Assuming we want to achieve the latter then I see five prerequisites needed to realize it:

1) Harmonization of the regulatory treatment of the financial sector (banking, insurance, asset management, pension funds), including taxation and capital standards.

2) Harmonization of bankruptcy laws and wind-down and recovery procedures.

3) Evolution of common financial infrastructure such as clearing houses for security and payment settlements.

4) Evolution of common deposit insurance.

5) Introduction of a common credit, and regulatory, risk-free asset.

A lot of progress toward realizing CMU can be achieved via steps one, two and three, which do not require TFEU changes.

Concerning the regulatory treatment of capital, so long as regulators at the national level where implementation occurs, even those who are members of a single college or mechanism of supervisors, use different definitions of what constitutes risk-free and risky assets, then impediments to the cross-border movement of capital will continue to occur.

Without such harmonization we will experience geographical compartments of assets backing liabilities in the same national jurisdiction rather than consolidated at the holding company level. If the national regulator in country X, for example, defines its government's bonds as risk-free for capital reserve purposes but the bonds of government Y as risky, then it will inhibit the flow of savings from country X to country Y. This may well be justified according to a credit metrics. The crux of the issue is that Europe's companies and savers are increasingly active across borders within the Single Market while our governments are predominantly geared toward national jurisdictions.

I would like to highlight the importance of financial market infrastructure for a properly functioning CMU. Without the "pipes and plumbing" as it is colloquially referred to CMU will not realize its full potential.

Let me give you an example concerning the settlement systems. Each day we sweep all cash balances in our accounts away from the custodian bank into overnight maturity repo, e.g. we lend cash overnight against borrowing securities for same-day settle (denoted T0 settle for trade day plus zero).

Standard securities settlement in Europe has now been shortened to two days (T2). In order to settle T0 we must complete all transactions and ticket entry by about 9:30-10:00am Central<x-apple-data-detectors://2> European Time. Anything later than that risks settlement failure. This is possible but our bank counter-parties essentially provide the service as an exception in the knowledge that our middle and back office processes work efficiently. Our colleagues in the United States perform the same operations but they have three settlement windows within the same day for T0 settle. T0 settlement is not the defining feature of a CMU but it is hopefully an example of the different stages of development between the European and American financial systems.

I would like to finish with an observation on portfolio composition that may give a practical insight into what the benefits of a full CMU could mean for Europe. We have two broad books of business that can be described as a set of portfolios in the United States using the dollar as base currency, and a set of portfolios in Europe using the euro as base currency.

We can calculate the percentage share of euro assets issued by entities in Europe that are held in dollar portfolios; and the percentage share of dollar assets issued by entities in the United States that are held in euro portfolios. Typically these non-base currency holdings are currency hedged back to the base currency, so the motivation for choosing the securities is not to gain foreign currency exposure but has to do with the characteristics of the bonds. Currency exposure is a separate decision that is usually implemented via currency forwards.

What we observe is that on average our euro portfolios hold a larger percentage share of dollar assets than the percentage share of euro assets that are held in dollar portfolios. Where the euro portfolios hold dollar assets they are typically corporate bonds, mortgage backed and asset backed securities. Where the dollar portfolios hold euro assets they are typically government bonds and corporate bonds.

While this is partly a reflection of the different net international investment positions of the two regions, it also reflects that the dollar market offers more liquidity, depth and choice to investors than the euro market. If we consider it desirable to increase European companies' access to capital markets and decrease their reliance on bank loan funding, then there certainly is more to do to complete the CMU.