

CMU future steps

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1. The CMU has not triggered significant market growth or integration so far

1.1 EU capital markets have not significantly grown since 2015

Despite major efforts made with the Capital Markets Union (CMU) initiative to complete and improve the capital markets regulatory framework since 2015 and nearly 50 legislative and non-legislative measures set out through three successive action plans, no major progress can be observed in terms of size or level of integration of EU capital markets at this stage¹.

European securities and derivative markets remain under-developed compared to other major jurisdictions such as the US or the UK and also relatively to the share of the world GDP represented by the EU. The EU's share of global capital market activity amounted to 10% in 2022 compared to a share of world GDP of 19%. In addition, this share has significantly decreased over the last 15 years down from 18% in 2006, showing that the development of EU capital markets lags behind other regions such as the US and APAC. In the same way, no real progress has been observed in the funding of EU non-financial corporates, which remains mainly bank-based or in the participation of EU households in the capital markets².

EU capital markets also remain quite fragmented, limiting available liquidity pools, despite the efforts made by the EU institutions to complete and strengthen the EU single rule book for capital markets and to increase post-trade connectivity³ and some consolidation movements at the trading level. Some positive evolutions have been observed in the market in the last few years such as a growth of cross-border investment fund volumes, but

intra-EU cross-border activity is still limited or below its potential in many areas of the market such as equity issuance and holding, cross-border post-trading costs remain high and industry players still face divergent applications of certain EU rules, notably in the retail space⁴.

The limited short-term development of EU capital markets is understandable, given that many CMU actions are still in the implementation phase. Additionally, the macroeconomic landscape of recent years with lower real interest rates compared to the US has hindered investment in the EU and market volatility stemming from geopolitical events has limited retail investment, despite an uptick during the pandemic. However, this lack of growth in the European capital market indicates that the CMU initiative has not yet triggered significant momentum in the market. Furthermore, the EU has missed opportunities to capitalize on major events such as Brexit and the post-pandemic growth recovery, which should have served as catalysts for stimulating the growth of its capital markets.

1.2 Factors limiting the impact of CMU measures

The disappointing short-term development of EU capital markets can be attributed to various factors. Recent articles in the latest Eurofi Magazine (February 2024) and recent papers on the CMU offer a range of explanations.

Some explanations relate to the complexity of the EU capital market landscape and to existing EU legislative processes and competencies.

One of the obstacles most frequently highlighted is the lack of robust political commitment behind the CMU, despite support expressed in many European Council and Euro Summit statements,

1. See Eurofi note of the February 2024 Regulatory Update 'Update on the progress made on CMU' for further detail on current market trends

2. Bank lending still represents 76% of the corporate borrowing of EU NFCs, compared to 27% in the US, despite a slight increase of the share of corporate bonds over the last few years. The proportion of financial assets held in currency and deposits by EU households remains much higher on average than in the US (30% compared to 12%) and nearly two-thirds of EU member states have a share of bank deposits above this average. See the Eurofi note of the February 2024 Regulatory Update for further detail and statistics – Update on the progress made on CMU.

3. Post-trade connectivity has improved with the implementation of TARGET2Securities and open access measures, but the EU still counts multiple post-trading infrastructures operating at domestic or multi-domestic level in stark contrast with the US. The wholesale banking landscape is also more fragmented than in the US or UK. A recent Amafi report shows that very few European banks have a global scale in terms of capital market activities and there is a multiplicity of banks with a more limited regional or local relevance due to limited consolidation in the EU banking sector – Amafi Which priorities for EU capital markets? – January 2024.

4. See ESMA Costs and Performance of EU Retail Investment Products 2023, AFME CMU KPIs November 2023 for example.

albeit in general terms. This is evidenced by instances where certain CMU measures proposed by the Commission have been diluted or carved-out at Council or Parliament level, for example concerning supervision or securities market rules. The overall slow pace of CMU measure adoption and ongoing competition among Member States to bolster their individual financial centres are further illustrations. This situation is to a large extent the result of the EU legislative process, which entails lengthy negotiations between co-legislators on compromises, while considering diverse industry and Member State positions. However, concerning the CMU, there is a prevailing frustration that the outcomes of this process so far appear to fall short of the initial ambitions to significantly develop and integrate capital markets at the European level.

Closely linked to the previous impediment is the difficulty of constructing a compelling narrative around CMU to mobilize Member States and industry. This difficulty is partly inherent to the complexity of the project itself, as the development of capital markets necessitates multiple technical and specialized actions that are challenging to encapsulate in a straightforward narrative. Moreover, no single legislative action or institutional change can bring the CMU forward in a credible way. While efforts have been made to link the CMU to economic objectives, such as the necessity of increasing investment to stimulate growth and innovation, the CMU is still lacking a convincing narrative based on a precise evaluation of expected macro- and micro-economic benefits⁵.

CMU, as a policy framework mainly, is also constrained by the limits of EU policy-making. Several policy areas which are key for the further development and integration of EU capital markets are either outside the direct competences of the EU (e.g. pensions, education, taxation) or imply actions in areas beyond the scope of financial services regulation (e.g. corporate and securities laws). If it proves impossible to reform these areas, EU capital markets will not be able to compete on equal terms with the US or with other integrated jurisdictions and the CMU will always be sub-optimal. Another area where EU policy-makers do not have a fully free hand is market structure, since market infrastructures are private sector entities, except for the ECB run TARGET2 Securities. The dependence of the EU on third-country CCPs for some key segments of the derivative market that is being tackled by EMIR 3 is a further issue, from a systemic risk and also from a strategic autonomy perspective.

A further challenge arises from the heterogeneous nature of the EU capital market landscape, which requires objectives and actions to be adapted to different market situations and levels of maturity. While some Nordic and Western European countries boast well-developed capital markets, many Central and Eastern European (CEE) and Southern European Member States have limited capital market activity, relying heavily on bank financing instead. Additionally, some Member States have sizable domestic markets while others mainly serve as export hubs for their products to other EU countries.

Other factors contributing to the limited short-term development of EU capital markets relate more to the way the CMU initiative has been structured and managed so far.

There is a widespread perception that the current approach to the CMU has pursued too many objectives without clear focus or clarity. In addition to the primary objectives of developing and integrating capital markets, several ancillary goals such as private risk-sharing, supporting the green and digital transitions, and achieving open strategic autonomy have been introduced. While these objectives are relevant, their multiplication has blurred the overarching narrative of the CMU. In addition, the large number of actions, many of which involve reviews of existing regulations, and the importance given to 'low-hanging fruit' particularly in the two first action plans, have diverted efforts towards actions with more marginal effects. This has had a detrimental effect on the momentum of the project and has led to a loss of focus on priorities, ultimately resulting in what is perceived as 'CMU fatigue'.

This perception is reinforced by the fact that several actions outlined in the initial action plans have failed to bolster significant volumes in EU capital markets. Examples include the initial iterations of ELTIF, PEPP, STS securitization measures⁶, and the initial wave of measures supporting SME listings, none of which have resulted in substantial additional investment or funding volumes. It is hoped that the actions of the September 2020 action plan, stemming from the recommendations of the CMU High Level Forum aimed at introducing 'game changers' for the CMU – such as the European Single Access Point (ESAP), the implementation of consolidated tapes, the Listing Act, and the Retail Investor Strategy proposal – will prove more effective in attracting issuers and investors to the EU market.

5. For example in terms of financing costs, funding capacity, investment return for investors, market resilience.

6. European Long-Term Investment Funds (ELTIF), Pan-European Personal Pension Product (PEPP), Simple, Transparent, and Standardized (STS) securitization.

2. The revival of the CMU debate with a new European political cycle approaching

2.1 A growing political recognition of the importance of CMU

The growing awareness of the high level of investments needed for Europe to remain competitive compared to Asia and the US and to fund future growth and innovation, as well as the post-Covid EU open strategic autonomy objectives, have revived the political debate around the CMU. There is now an increasing recognition at the political level (Council, Eurogroup...) of the essential need and urgency to build strong capital markets in Europe, leveraging the scale of the single market, to better connect EU household savings to productive investment and retain growing and innovative firms in the EU.

There is indeed a general consensus that public spending – constrained by high levels of public debt and limited potential for fiscal capacity enhancement – and bank financing – restricted by prudential requirements and unable to finance the most innovative projects – will not be sufficient to provide the high amounts of financing needed for supporting the green transition, boosting technological competitiveness and diversifying supply chains. It has indeed been estimated by the European Commission that the green transition alone will require additional investments of €620 billion every year on average until 2030 and a further €125 billion per year will be needed for the digital transition⁷, amounts which are compounded by different geopolitical and demographic pressures⁸. In addition, the funding of innovation is currently insufficient in the EU and the gap with the US in terms of long term investment capacity is increasing with the Inflation Reduction Act (IRA). It is estimated that at present around 20% of EU tech firms are acquired by US firms because of the lack of adequate exit strategies in the EU and more than 50% of late stage financing (\$50 Mio+) of EU companies comes from outside the Union. The limited short term economic growth prospects of the EU economy are a further challenge.

Private capital, including a greater share of the European household saving capacity, which is

much higher than in the US (around 14% of disposable income is saved by European households compared to around 5% in the US) will therefore need to be put at use for funding these investments, which is one of the objectives of the CMU⁹. Firms also need to diversify their funding with a greater use of equity financing, to innovate and achieve more growth.

2.2 On-going initiatives at EU level on the future of the CMU

As a new European political cycle is approaching, several initiatives have been launched by the European institutions to make proposals for relaunching the CMU, showing a renewed political commitment behind the project.

In response to a call from EU leaders at the Euro Summit in March 2023 for stepping up collective efforts across the Union to take forward the CMU, the **Eurogroup** has committed to working on measures for deepening the CMU and enhancing the engagement at national level around the initiative. Following a stock taking exercise and assessments conducted during the second semester of 2023 with a large number of public and private sector stakeholders at EU and domestic levels, the Eurogroup President is preparing a set of political priorities on CMU due to be negotiated with the Members States and presented at the Euro Summit in March 2024.

The **German and French Finance Ministers** also laid out joint priorities to move forward on CMU¹⁰ including: an improvement of public market access for SMEs with the EU Listing Act, measures to increase retail investor participation, a revitalisation of the securitisation market, an improvement of the European sustainable finance framework and a strengthening of the EU securities market infrastructure. Following this statement, the French Minister of Finance has tasked a committee of experts in January 2024 with making recommendations for enhancing the financing conditions of EU businesses that could contribute to the future stages of the CMU.

The **high-level report on the future of the single market that is being prepared by Enrico Letta** for the European Council for March 2024 is also expected to address the CMU and how to enhance the single market for capital, which is considered

7. Source: 2023 Strategic Foresight report.

8. Age-related expenditures could increase by 2 percentage points to 26% of GDP by 2070 – Source Amafi – Which priorities for EU capital markets – January 2024.

9. The high saving rate in the EU (calculated as gross saving divided by gross disposable income) compared to the US (around 14% in the EU in 2023 up from 12% before 2019 compared to about 4.5% in the US) shows the significant potential that exists for the increase of investment in financial assets in the EU. The lower rate of saving in the US may however be accentuated by the fact that a significant proportion of savings in the US are invested in mandatory retirement plans such as 401 (k) which represent up to 10 to 14% of disposable income, when considering employee and employer 401(k) contributions, part of which may not be taken into account in the evaluation of the gross savings of households. Sources Eurostat indicators 5 October 2023, Fidelity Q2 2023 retirement analysis. According to some estimates, there is an annual saving surplus in the EU²⁷ of about € 330 Mio.

10. See op'ed published in the FT by Bruno Le Maire and Christian Lindner – We must close the EU capital markets gap – Financial Times 13 September 2023.

as the area where the single market has been least successful so far¹¹. In the same way, the **report on EU competitiveness commissioned from Mario Draghi** by European Commission President Ursula von der Leyen aiming to make proposals to revitalise the EU's economy in the face of competition from China and the United States, could also include aspects relevant for the CMU.

3. Possible ways forward for the future stages of CMU

When reviewing the contributions to the February 2024 Eurofi Magazine, along with recent statements from prominent public sector figures and industry representatives regarding the future steps of the CMU and recent reports on CMU from market stakeholders, three main paths for advancing the CMU emerge. These proposals, which address both the substance of the actions required to deepen the CMU and the method of implementation, can be to a large extent combined and should serve as a basis for shaping the CMU strategy moving forward.

3.1 Focusing on a smaller number of transformational priorities

Many stakeholders recommend narrowing the focus of the CMU initiative to a smaller set of high-impact priorities, likely to drive more tangible progress in the growth and integration of EU capital markets. The suggested priorities encompass policy objectives, drivers for capital market development, and additional policy actions. However, the extensive and diverse list of proposals put forward by public authority and private sector representatives shows the need for further prioritisation, taking into account the potential impact of these actions on market growth and integration, as well as their feasibility.

Moreover, it has been suggested that the ability of the measures proposed and adopted to attract

investment to the EU and support the funding of EU firms should be more systematically evaluated throughout the legislative process, with market impact or competitiveness pre-implementation tests (along with post-implementation monitoring), to ensure that the regulations adopted effectively foster an environment conducive to the development of EU capital markets¹².

Among the most commonly proposed priorities for the future steps of the CMU are:

- Developing larger pools of long-term savings within the EU, likely to be invested in the EU capital markets with actions to develop private pensions and retail engagement in the capital markets¹³.
- Revitalizing the EU securitization market to develop the market for asset-backed securities, leveraging banks' risk assessment capabilities, while enhancing bank financing capacity¹⁴.
- Further harmonizing corporate insolvency rules and withholding tax processes, beyond the targeted measures of the current action plan.
- Strengthening equity markets to diversify the funding for EU firms and offer savers greater long-term returns with measures such as the DEBRA proposal (Debt-Equity Bias Reduction Allowance)¹⁵ and continued efforts to facilitate access of SMEs to capital markets building on the Listing Act.
- Enhancing supervision with increased EU-level supervision for cross-border and systemic activities and measures to enhance the agility of EU rule-making¹⁶:
- Improving the EU sustainable finance framework with manageable requirements to sustain and expand European leadership in the area of ESG, and placing greater emphasis on transition finance.
- Supporting the provision of adequate (tax) incentives on the investor and issuer sides, including DEBRA and the FASTER proposal to improve cross-border withholding tax procedures¹⁷.

11. See remarks made by E. Letta during a meeting with the ECON Committee in October 2023.

12. At present an impact assessment of the legislative proposals made by the Commission is systematically performed, but the measures adopted following the trilogues are not systematically subject to additional impact assessment. A set of CMU KPIs is measured by the Commission on an annual basis but these do not relate to specific legislative measures.

13. Actions proposed include enhancing private pension products such as the PEPP, implementing tax incentives for investors, and bolstering efforts to increase retail participation building on the actions proposed in the Retail Investment Strategy (RIS).

14. This would involve a review of prudential calibrations – capital charges for the holding of securitized assets by banks in the CRR and insurance companies in Solvency II and a review of the treatment of ABS in the LCR (liquidity coverage ratio) – and a review of disclosure and due diligence requirements in particular.

15. DEBRA proposes mechanisms to rebalance the cost of debt and equity financing for non-financial corporations.

16. Many proposals are made by market stakeholders in this area including a mandatory or optional transfer of supervisory competences concerning cross-border activities or entities to the EU level, notably for the more systemic ones, an improvement of the supervisory coordination between the ESAs and the national competent authorities building on the RIS proposals, possible changes in the governance and decision-making processes of the ESAs to evolve towards a model closer to ECB, along with measures to enhance the agility of the EU legislative process, such as the use of no-action letters. Some commentators also suggest that more radical changes in terms of supervision, such as a transfer of all cross-border competencies to the ESAs would accelerate the achievement of a single rulebook.

17. DEBRA is an example but some stakeholders also propose measures to increase the consistency of tax incentive approaches at EU level. The limited progress of DEBRA so far however illustrates the challenge of making any changes in the area of tax rules beyond possibly unifying processes to avoid double-taxation, such as the FASTER proposal to improve withholding tax procedures.

Some stakeholders also suggest that future CMU priorities should encompass more than just regulatory and supervisory measures. They argue that addressing catalysts such as product innovation, market structure, issuer and investor incentives, market access and data availability is also crucial for growing the European capital market.

Some measures are proposed on the product side, for example to build new investment products with a European scale such as an EU equity fund covering all major EU 27 indices or an IPO fund that may attract investment from savers in all Member States.

Certain commentators have also highlighted the importance of taking steps to streamline the current capital market infrastructure and avoid fragmentation in new areas of development. Proposals include the establishment of new EU platforms in niche or emerging areas of the capital market, potentially through joint ventures involving existing exchanges, such as the development of common EU infrastructures for tokenized assets, laying the groundwork for a future digital CMU, and efforts to consolidate SME exchanges to enhance liquidity in these markets. Furthermore, actions at the regional level may be beneficial and pave the way for the development of interconnected regional ecosystems, as demonstrated by the cooperation in this area among the Baltic countries¹⁸. Suggestions also include encouraging more significant EU level capital market integrating moves at the trading or post-trading levels¹⁹. While such audacious moves at EU level hold promise for accelerating integration, their feasibility from both political and capitalist perspectives remains to be demonstrated.

The setting of ambitious targets in terms of digitalisation of trading and post-trading activities and investment product distribution is also proposed, which may include specific measures to support the implementation of DLT and AI in securities markets and an adoption of the FiDA open finance measures proposed by the Commission, as well as bolder standardisation such as a shortening of settlement cycles in order to lead to greater digitalisation²⁰.

3.2 An improved balance between a top-down and bottom-up approach to CMU

A second debate, which concerns both the content of the measures and the way they are implemented relates to whether future stages of the CMU should prioritize top-down or bottom-up approaches²¹.

Recently, there have been several calls for emphasizing a top-down approach to the CMU and a greater focus on integration. Advocates argue that EU-level actions, such as implementing a unified rulebook and creating a single market for capital, are vital for providing financing to support innovation and address challenges related to the green and digital transitions, which are shared objectives among all EU Member States. Broader capital markets are indeed essential for innovative firms to have access to sufficient financing, necessitating greater harmonization and integration efforts. Additionally, integrated markets can lower financing costs for all firms and improve private risk-sharing across the EU.

In November 2023, the ECB President advocated for a 'Kantian shift' towards a more top-down CMU approach²², emphasizing the need for a European SEC to enforce a unified rulebook and market infrastructure consolidation. Similarly, the IMF General Manager, in June 2023²³, urged greater emphasis on the 'Union' aspect of the CMU, proposing a single access point for disclosures and information, rule harmonization (including corporate insolvency), supervisory convergence, and the creation of interconnected clusters of expertise on the continent, rather than multiplying separate domestic financial centres. Additionally, a former ECB Executive Board member highlighted the necessity of a permanent European safe asset²⁴, as a common form of collateral and a risk-free benchmark necessary for pricing risky financial products²⁵.

A top-down approach also relates to the way CMU measures are adopted and implemented. The CMU High-Level Forum for example proposed in 2020 to seek an upfront commitment from the Commission, the Council and the Parliament on the main components of the CMU action plan, including a joint delivery timetable, monitored and enforced by all the EU institutions²⁶.

18. Actions supported by the EBRD have been conducted in the Baltic region to better align taxation, market regulation and green taxonomy which has facilitated integration and connectivity of market infrastructures, along with the establishment of a regional index. See Eurofi Views Magazine February 2024 O. Renaud-Basso.

19. This may involve major cross-border mergers in the stock market or clearing and settlement domains to create pan-European scale and create bigger pools of liquidity.

20. See David Wright's editorial Eurofi Views Magazine February 2024.

21. The top-down approach involves EU-level actions aimed at implementing a unified rulebook and a single market for capital and possibly fostering market consolidation, while the bottom-up approach focuses on developing existing domestic capital markets, potentially involving gradual harmonization efforts across these markets.

22. Speech by C. Lagarde at the European Banking Congress, 17 November 2023 'A Kantian shift for the Capital Markets Union'.

23. IMF Managing Director's remarks on strategic priorities for the European capital markets, 15 June 2023.

24. F. Panetta, ECB Blog, 'Europe needs to think bigger to build its capital markets' 30 August 2023.

25. A common form of collateral in the EU would also promote centralised clearing and cross-border collateralised trading, helping to attract foreign investors.

26. Final Report of the High Level Forum on the Capital Markets Union – June 2020 The report also proposed that Member States should subsequently commit to 'swiftly and faithfully' implement the agreed measures and pursue measures at national level in domains where there are no EU policies yet. However, these proposals have not been implemented so far.

However, CMU measures must also address the diverse needs of EU countries, particularly regarding SME financing and retail engagement, while promoting capital market development in countries where markets are underdeveloped. Bottom-up approaches are necessary to address these varied needs, but the aim should be to support progress towards common objectives and rules, albeit at a speed adapted to markets' maturity level, requiring coordinated EU-level efforts.

An improved and more explicit combination of top-down and bottom-up approaches is therefore likely needed for future stages of the CMU, taking advantage of the complementarity of these two approaches. Merely developing domestic markets and integrating them bottom-up with harmonization efforts, may fall short as separate domestic markets and national specificities would persist, hindering the creation of large, efficient capital markets in Europe. Hence, a top-down approach is necessary to achieve a single capital market over time – with features such as common European rules and procedures²⁷, consistent enforcement and supervision of rules across the EU and single access points to the EU market – combined with coordinated efforts to support progress of all Member States towards these objectives²⁸.

3.3 A more comprehensive approach, better involving Member States and all components of the ecosystem

A third aspect to consider in managing the CMU process that some stakeholders have emphasized, is the necessity for a comprehensive strategy that engages both Member States and the various sectors of the financial industry operating within the capital markets. Such a holistic approach must also encompass monetary policy considerations, as investor attraction to EU capital markets is influenced by interest rates and interest rate differentials with other regions, alongside broader macroeconomic conditions.

While EU-led regulatory actions are essential for building CMU, they may not be sufficient due to many capital market aspects lying beyond EU policy-making competencies. These include tax incentives for retail investment, financial education, pensions, corporate insolvency rules, which are all predominantly under Member State control. While the initiative led by the Eurogroup President and forthcoming reports from Enrico Letta and Mario Draghi may set the stage for an inclusive process involving Member States, it is uncertain whether

they will address these areas under domestic competence, notably the most contentious ones, such as insolvency laws or tax.

The proposal from the French authorities to collaborate with like-minded Member States to explore coordinated actions or enhanced cooperation could offer a way forward for addressing some domestic competence areas. However, careful consideration is needed to prevent increased fragmentation within the EU as a result.

These actions should ideally pave the way for potential EU-level implementation, albeit at varying speeds, aligning with the coordinated bottom-up approach mentioned earlier.

Similarly, engaging all industry participants contributing to EU capital market development is crucial. This includes banks, and insurance companies that play essential roles as gateways to the capital markets for investors and issuers, traders and market-makers in the secondary markets and institutional investors. Initiatives to ensure that prudential requirements do not excessively impede the capital market activities of these players and to better align requirements such as MiFID and IDD must be pursued. Establishing appropriate linkages between the Banking Union and CMU initiatives is also imperative, as a robust and more integrated EU banking sector is essential for the development of cross-border EU capital markets.

27. Including notably common capital market rules, common key corporate laws for the capital market, common tax procedures to avoid double taxation.

28. See contribution by J. Berrigan to the Eurofi February 2024 Views Magazine for example.