

# Update on the progress made on CMU

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## 1. Overall progress made on the Capital Markets Union action plans

The Capital Markets Union (CMU) initiative was launched in 2015 with the objective of developing and further integrating capital markets in the EU. Several goals were put forward by the European Commission including a further diversification of the financing of EU enterprises, support for the green and digital transitions, an improvement of long term investment opportunities for savers and an enhancement of resilience and private risk sharing across the EU.

More than 40 legislative and non-legislative actions have been proposed by the Commission since 2015 to implement the CMU, in three main action plans.

The measures of the two initial CMU action plans published in 2015 and 2017 are now in force. These action plans prolong and complete previous work initiated with the Financial Services Action Plan (FSAP) to develop a common framework for securities and derivatives markets, with measures covering a wide range of areas including: prospectuses and SME listings, securitisation, the cross-border distribution of investment funds, prudential calibrations of capital market activities for banks and insurance companies and supplementary pensions with the PEPP<sup>1</sup> framework. Measures were also proposed in the 2017 action plan to strengthen the powers of the European Supervisory Authorities (ESAs), develop the role of fintech in the capital markets and promote sustainable finance.

A third action plan was set out by the Commission in September 2020, comprising several new proposals such as the Retail Investment Strategy,

the European Single Access Point (ESAP) to EU corporate information, a Listing Act and a targeted harmonization of corporate insolvency rules, as well as reviews of the main existing capital market legislations MiFIR, EMIR, CSDR, ELTIF and AIMFD/UCITS. These measures are aimed in particular at further increasing the engagement of retail investors and SMEs in the capital markets and also facilitating access to EU capital markets, notably with the implementation of the ESAP and consolidated tapes at EU level.

Most of the legislative proposals of the September 2020 CMU action plan have now been adopted at Level 1, except the EMIR 3 review and the Retail Investment Strategy (RIS). A deal was struck between the ECON Committee and the Council on the EMIR 3 proposal on February 7<sup>th</sup> that needs to be formally adopted by Parliament and Council. The RIS proposal is less advanced<sup>2</sup>. It is expected that a position can be agreed by the ECON Committee by the end of the current legislature and also that a general approach can be reached in Council by June 2024, but trilogues on the RIS will most likely start with the new Parliament and Commission.

Two initiatives that may contribute to the objectives of the CMU have also been proposed in the fiscal area: FASTER (Faster and Safer Relief of Excess Withholding Taxes), which aims to improve withholding tax processes and DEBRA (Debt-Equity Bias Reduction Allowance), which proposes mechanisms to rebalance the cost of debt and equity financing for non-financial corporations.

In parallel, efforts are being made to develop local capital markets<sup>3</sup>, for example through the Technical

1. PEPP: Pan European Pension Product.

2. In October 2023, the ECON Committee rapporteur published her draft report on the RIS proposal in which she proposes to delete the partial ban on inducements and the development and use of benchmarks under the Value for Money (VfM) approach, as well as proposing a less stringent best interest test. Views across the political groups still differ substantially on these issues at the time this note is written (some groups would support a full inducement ban and maintaining VfM benchmarks). The vote in ECON is scheduled to take place in the second half of March 2024. In the Council, discussions on the proposal have progressed under the Spanish Presidency and negotiations are set to continue under the Belgian Presidency with the goal of reaching a general approach. Similar to the situation in the Parliament, the most challenging discussions revolve around the partial inducement ban and value for money provisions.

3. The actions proposed in 2017 to support the development of local capital market ecosystems included: the provision of technical support to Member States through the Technical Support Instrument (TSI) or previously the Structural Reforms Support Programme (SRSP) and the establishment of a CMU Working Group by the Vienna initiative to promote the diversification of investment finance in the region. The Commission proposed to establish a comprehensive EU strategy in 2018 on steps that could be taken at EU level to support local and regional capital market development across the EU.

Support Instrument (TSI), whereby the EU provides technical assistance to certain EU Member States for reforms that include the development of their capital markets. Actions are also being undertaken by certain member states, in some cases with the support of the Commission's TSI or in connection with the IFIs<sup>4</sup>, to implement national strategies aiming to improve their market ecosystems. The EBRD for example has been playing an active role in facilitating the implementation of national strategies in Central Eastern European (CEE) countries and supporting the consolidation and inter-connection of domestic exchanges in the CEE region.

## 2. Impact of CMU on EU capital markets size and activity

Statistics and indicators show that the major efforts made since 2015 in the context of the CMU initiative to improve the EU capital markets framework have not yet translated into significant growth and integration of EU capital markets or in a stronger role of capital market instruments in the funding of firms or household savings<sup>5</sup>. This is understandable, since many actions are still in the process of being implemented, but shows that the CMU has not kickstarted strong progress at market level yet.

### 2.1 Short term impacts in terms of growth and integration of EU capital markets

European capital markets remain under-developed compared to other developed regions, in terms of size relative to GDP and did not grow significantly over the last few years. In addition there is a widening gap with the US and some APAC countries in terms of capital market activity. Although structural differences (e.g. in the pension systems, the way capital markets and banks have evolved historically, the structure of the economy...) mean that the US in particular cannot be considered as a direct benchmark for the EU, the comparisons

below show that there is still a long way to go to bring European capital markets into line with the size of the European economy, particularly in the retail space and in terms of funding of firms.

At the end of 2021, EU securities markets were about half the size of those in the US in percentage of GDP and also smaller than those of major economies such as Japan, China and the UK. The total of EU27 debt securities and public equity markets represented 233% of GDP compared to 449% for the US, with the main difference coming from public equity markets which amounted to 81% of GDP in the EU compared to 227% in the US. In addition, while US public equity markets practically doubled in % of GDP between 2015 and 2021, the increase was only of 30% in the EU<sup>6</sup>.

Some more recent figures<sup>7</sup> confirm the limited growth of EU capital markets over the last few years and their under-representation in relation to the size of the economy. Between 2006 and 2022, the EU's share of global capital market activity has decreased by more than 40% (10% down from 18%) while the APAC's share rose significantly (to 31%) and the US's share decreased but remained high (47%). In addition, the EU's share of global capital market activity (10%) remains significantly lower than its share of the global economy (19% of global GDP). The gap with the % of GDP is particularly high for IPOs and pension assets (9 and 10% share of global market activity in these areas) which are important determinants of future market growth.

European capital markets also remain fragmented, which limits their efficiency, liquidity and depth, with persistent home bias in the detention of equities and bonds and in the issuance of equity<sup>8</sup>, although a growth of cross-border investment fund volumes has been observed. The level of development of capital markets is also quite variable across the EU, with strong markets in the Nordics, relatively well developed capital markets in some Western European countries such as France, the NL, Belgium and practically inexistent markets in many Southern and Central Eastern Europe (CEE) countries<sup>9</sup>.

4. IFIs: International Financial Institutions such as the EIB, the EIF or the EBRD.

5. According to the AFME CMU Key Performance Indicators published in November 2023, the competitiveness of EU capital markets has not improved either over the last few years and remains significantly lower than the US and the UK. This is true for all the key indicators of competitiveness measured by AFME (available pools of capital, access to finance of NFCs, level of market liquidity and the adoption of new trends such as sustainability and digitalisation) except for the role played by sustainable finance, where the EU is in a leading position. In the EU a higher proportion of ESG bond issuance as % of total bond issuance than other regions is observed (12.7% in H12023 compared to 7% in the UK and less than 1% in the US).

6. Source CEPS Time to re-energize the EU's capital markets November 2022. In the US public equity markets grew from 137% of GDP to 227% between 2015 and 2021, whereas in the EU27 they grew from 61% of GDP to 81% during the same period. Figures from 2020 also show that the EU-27 average stock market capitalisation amounted to 52% of GDP in EU-27 in 2020, compared to 116% in the UK and more than 190% in the US.- Source World Bank database. Capitalisation represented by the outstanding listed shares issued by domestic firms. Further detail can be found in a note on CMU drafted by Eurofi in April 2023 – Capital Markets Union: progress made and future steps.

7. New Financial – EU capital markets : a new call for action – September 2023.

8. The AFME CMU KPIs of November 2023 show that while the level of intra-EU integration is quite limited in terms of equity issuance and holding and debt holding, it is high for debt issuance.

9. In terms of % of GDP, Sweden (155%), Denmark (150%), the NL (136%), France (134%) and Belgium (110%) have significant market caps, but many Southern and CEE countries have % of market cap below 30% with an EU average of 55%- Source CEIC database (2022).

## 2.2 Evolutions in terms of access to capital of NFCs

When considering the access to capital of firms, EU non-financial companies (NFCs) remain very reliant on banks<sup>10</sup>. 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<sup>11</sup>. More broadly, the share of tradeable assets (debt securities and listed equity) in the overall funding structure of EU NFCs remains low in 2022 (26%) compared to the US (68%), the UK (42%) and Japan (48%)<sup>12</sup>.

Statistics also show that the proportion of NFC funding derived from bond and equity issuance has decreased compared to the years preceding the pandemic (10.3% in H12023 compared to an average of 11.5% between 2016 and 2019) and compared to the peak of 2021 (14%). A fall has been observed notably in terms of IPO issuance volumes, although this is not specific to the EU. The proportion of equity financing compared to debt in the funding of NFCs remains stable with a slight decrease in 2022<sup>13</sup>.

Equity market statistics moreover show that although equity underwriting increased in 2023 on European exchanges, this is due to secondary equity issuance, while IPOs have decreased by 50%. Equity trading also decreased on European trading venues in 2023<sup>14</sup>.

## 2.3 Available pools of capital

The participation of EU households in the capital markets has not improved significantly either over the last few years, and the pools of capital available for investment in the capital markets are also significantly below the potential of the EU economy.

Figures from 2021 show that 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. In addition, the share

of assets held by households in securities (equities and investment funds) is much lower in the EU (about 25%) than in the US (about 45%)<sup>15</sup>.

Aggregate statistics on available pools of capital confirm this gap with other regions. First, the total size of financial assets in the EU<sup>16</sup> is about half the size of the US and lower than the UK in % of GDP (254% of GDP in the EU compared to 553% in the US and 339% in the UK in 2022). In addition, pools of capital are growing more slowly than in the US (total EU pools of capital increased by +15% since 2014 in the EU compared to +30% in the US). Moreover, the share represented by longer-term assets such as pension assets and securities did not grow significantly within EU household assets over this period<sup>17</sup>.

The proportion of household financial market assets (*i.e.* excluding cash, deposits and unlisted equity) in the EU also remains much lower than in the UK and the US as a % of GDP (90% compared to 182% in the UK and 310% in the US) in H1 2023, with a decrease since 2018 (98%)<sup>18</sup>.

10. This predominance of bank funding in EU can partly be explained by the greater importance of SMEs in Europe, which may prefer bank financing and non-listed equity financing due to the complexity and governance impacts of listing on a stock exchange.

11. New Financial - EU capital markets : a new call for action – September 2023. The share of corporate bonds compared to bank lending grew from 18% to 24% between 2012 and 2022.

12. Source: IMF background note on CMU for Eurogroup – June 2023. The KPIs published by the European Commission (Overview of CMU indicators – 2023 update – 16 August 2023) however measure a % of market funding closer to 50% in the EU that is stable, but this is calculated as the sum of corporate bonds and listed shares issued by NFCs relative to the sum of those two volumes and bank loans, whereas the IMF also takes into account unlisted equity (which is significant in the EU) and non-bank loans in the overall funding structure of NFCs.

13. Source AFME CMU KPIs November 2023.

14. See Equity primary markets and trading report 3 Q 2023 AFME.

15. Source: IMF background note on CMU for Eurogroup – June 2023. The proportion of household financial assets held in pension and insurance products is similar in total in the EU and the US, according to these statistics, but the split is different, with a much higher proportion invested in pension products in the US.

16. Including currency, deposits, insurance, pension assets and other financial assets.

17. Source: New Financial – EU capital markets : a new call for action – September 2023.

18. Source AFME CMU KPIs November 2023.