CMU: is there a need for a new approach?

1. Progress made on the CMU

Several panellists highlighted the importance of capital market financing and the capital markets union (CMU) initiative for the EU and its economy.

A policy-maker stated that Europe's financial structure must be enhanced to address the challenges of the 21st century. More investment is needed in smaller, more innovative and riskier projects than previously. It is becoming increasingly clear that such projects need more direct financing via the capital markets. Work has been ongoing in the EU since 2000 to develop and further integrate the capital markets. There is a tendency to downplay the progress that has been made on CMU, but a great deal has been achieved. Most actions proposed by the Commission since 2015 have been agreed by the co-legislators. However, this legislative progress has not yet translated into significant growth in the market, which remains below its potential.

An industry speaker emphasized that capital markets are an essential component of economic growth in a context where the potential of monetary policy has been exhausted and fiscal policy is running at its limits. Demand for financing is increasing in Europe with the twin transition, the deterioration of economic indicators in key EU countries, and increasing geopolitical tensions.

A second industry speaker agreed that much has been done in terms of reviewing existing legislation, adopting new legislation and strengthening market infrastructures, but no significant change has yet been observed on the ground in terms of market development. Market finance in Europe has not picked up and its share of the global capital markets has in fact decreased over the last 15 years[1].

The first industry speaker confirmed that EU capital markets have eroded over the last few years despite the efforts made on CMU. This is particularly the case for equity markets. The market capitalisation of listed companies as a % of GDP remains limited in the EU, amounting to about 50%, compared to 190% for the US. Some US bigtechs have a larger capitalisation than all EU equity markets combined. The EU also has a share of less than 8% of total trading activities globally. Companies are delisting in the EU, causing the loss of growth, innovation, jobs and tax money, and leading to a vicious cycle in relation to fiscal and monetary policy. This leads to growth forecasts being reviewed in several EU countries.

A regulator stated that much has been done to consolidate the capital markets framework. Some key actions are still to be implemented, such as consolidated tapes and the European single access point (ESAP). Despite these efforts, capital markets in Europe remain underdeveloped. Currently, European capital markets are unable to respond to increasing financing needs. This must be urgently addressed. The effectiveness and attractiveness of European capital markets should be improved.

A third industry speaker agreed that CMU is not where it needs to be. There have been some positive developments in new areas and significant steps forward towards harmonisation in the listing, the clearing and settlement spaces in particular, but more needs to be done.

A fourth industry speaker echoed the positive developments on CMU, such as the decision to implement consolidated tapes, the ESAP and the Listing Act. The Faster and Safer Relief of Excess Withholding Taxes (FASTER) proposal, which proposes new rules to make withholding tax procedures in the EU more efficient and secure, is also progressing quickly. However, as AFME concluded in its latest edition of the CMU Key Performance Indicators, there is no visible medium-term progress in terms of the development of EU capital markets at this stage.

2. Key challenges

A policy-maker attributed the slow progress on CMU mainly to the insufficient political backing behind the project so far. Convincing politicians of the need for CMU has been difficult. A wide range of interconnected actions, some quite technical, are needed to develop the capital market, so it is difficult to create a motivating political narrative around CMU. Many of the actions required are also outside the scope of finance ministries and other ministries may have different views. Corporate insolvency frameworks, for example, are in the scope of justice ministries and aim more to deliver social justice and to mitigate losses rather than to build a capital market.

CMU has also been hindered by strong vested interests at industry and member state levels, the policy maker added. The potential benefits of removing barriers to cross-border capital markets are felt by everyone in small amounts, whereas the cost of removing the barriers is felt very strongly by certain players who make rents from these barriers and tend to be more vocal than the majority. There is also significant competition among member states, some of which still believe that building their own capital market is more important than sharing a larger EU market. However, there is no point building 27 small markets that cannot compete globally.

1. 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%) – source New Financial – EU capital markets : a new call for action – September 2023.

An official noted that, despite the general commitment to the project, there is currently some ‘CMU fatigue’ within the Council and even scepticism about the possibility to relaunch the project. The political will is critical to meaningfully relaunch the CMU.

An industry speaker stated that persistent regulatory and supervisory fragmentation is hampering the creation of CMU. Consolidation efforts in the trading space for example face different national interpretations of common EU legislation due to local gold-plating. Despite the existence of a common technical trading platform covering several EU member states, it is difficult to operate on a fully consolidated basis because of fragmentation in the regulatory landscape. The situation is similar at the settlement level. TARGET2-Securities (T2S) is a great step forward but does not yet deliver all possible efficiencies, as only a limited amount of cross-border transactions are settled in T2S.

Another industry speaker noted that, while there is a shared understanding in Europe that a single market would facilitate capital flows between countries, capital bases and liquidity pools remain fragmented hindering the flow of capital. Market participants are confronted with differing measures and procedures across Europe in many areas, such as authorisations or taxation and this is true both for equity and debt.

3. Key priorities for the future steps of the CMU

The panellists suggested a number of issues and areas of action that should be considered in priority in the future steps of the CMU.

3.1 Mobilising long-term investment capacity across the EU to match capital needs

An industry speaker observed that there is a structural mismatch in Europe between the offer and the demand for long-term capital. Savings that are abundant in Europe are not appropriately invested with 80% of them left in bank deposits or invested in short term and debt financial products. Equity markets are insufficiently developed, and there is an excessive debt bias in the funding of firms. Tackling these issues should be the priority. The regulatory framework should encourage more long-term investment, notably in equity markets, in order to create more congruence between the abundant savings and the forthcoming capital needs. Products connected to workplace saving plans and private pension schemes with additional contribution from the employer should also play a greater role in directing household savings toward more long-term investment.

A second industry speaker suggested that the CMU requires bold new ideas to stimulate investment, such as establishing an EU equity fund covering major indexes from all 27 member states, weighted by the respective market capitalisation. This could allow all European citizens to invest in the European economy and should be paired with a common approach to capital gains tax in Europe and targeted tax incentives. A mandatory holding period could defer the impact of tax reductions on public finances, while allowing for new jobs and growth to be created. Additional ideas could be to create a European version of the 401(k) scheme that exists in the United States, and to ensure that all European member states provide individual savings and investment accounts such as the one that is available in Sweden. Pan-European employee participation schemes could also be developed to favour more equity investment. Such instruments could inject a huge amount of fresh capital into the real economy, while encouraging citizens to invest in the capital markets for the longer term and improving the viability of pension systems.

An official noted that the experience of the Pan-European Pension Product (PEPP) shows that it is difficult to establish a new investment product at EU-27 level. A more realistic solution in the short term could be to design a common savings product with a limited group of countries willing to cooperate. This is one of the concrete proposals on which the working group set up by the French Ministry of Finance to make proposals to relaunch the CMU has been working.

A regulator stated that ESMA also created a taskforce to consider how to develop effective capital markets in Europe. Three main areas of improvement were identified. Firstly, savings in Europe that are substantial, are not being deployed in the right way. Insufficient investments are made in the capital market and there is a need for larger institutional investors, pensions reform and tax incentives. Secondly, companies in Europe need to be able to find sufficient funding for innovative projects. Finally, there is continued fragmentation of European capital market regulation and supervision.

3.2 Enhancing the capital market ecosystem

An industry speaker emphasised that the ecosystem to support the CMU has not been sufficiently considered. Too many oligopolies and duopolies have crystallised in the EU capital market in areas such as rating agencies, benchmarks, asset management, which limits competition, diversity and hinders the achievement of an effective single market.

One idea to support equity markets in Europe would be to create a dedicated segment of the regulated markets devoted to small and mid-caps, with proportionate listing requirements, which would help these companies enter the market before progressively moving to the main segment. A joint venture could be set up between key EU exchanges, pooling together their small and mid-sized segments, to create a single access for IPOs in the EU under the supervision of ESMA.

A public representative agreed that changes are needed in the EU market ecosystem to encourage SMEs to seek funding on the capital markets. A good approach would be to create a European ecosystem in which smaller SMEs can choose whether or not to be subject to European rules until they grow bigger.

3.3 Enhancing supervision at EU level

An official stated that to build a European market, the endpoint should be for more powers to be delegated to

ESMA. The question is how to get there, given the present oppositions to a single supervision model. One solution could be to implement an opt-in mechanism by which players that operate on a cross-border scale, could choose to be supervised at EU level. This would allow to test the appetite for further integration. In parallel efforts should continue to enhance coordination among domestic supervisors at the European level.

An industry speaker stated that moving towards single supervision should be the objective. This is necessary to foster more market integration and the emergence of pan-European players and is possible to implement, but requires political will and a compelling narrative. An opt-in system will not create the desired level playing field and integration at EU level.

A second industry speaker considered that moving towards more EU level supervision is a logical next step to foster integration and agreed that opt-in is not the right solution. With opt-in, there is a clear conflict of interest, as supervised entities should not be allowed to choose who supervises them. Secondly, opt-in will not allow a sufficient level of harmonisation in the market. The Securities and Exchange Commission (SEC) model proposed by C. Lagarde at the end of 2023 could have a more meaningful impact, moving away from the polarisation between having powers at EU level or at national level. The supervisory system must foster further integration and harmonisation, while allowing the national competent authorities (NCAs) to continue to play a role.

A third industry speaker observed that member states are currently competing on supervisory intensity, which implies a lack of trust. A pragmatic solution could be to review the supervisory set-up each time a legislation is revisited, defining the level at which supervision can be conducted most effectively, based on an evaluation by the Commission and co-legislators of the degree of integration in the markets concerned. If the market is highly integrated with standardised products and few actors, then supervision at the supranational level is the most efficient approach; if not, domestic supervision with EU level coordination is fine. An opt-in system could also be part of the solution in this context.

A regulator agreed that there is still too much fragmentation at the regulatory and supervisory level in Europe. Effective supervision can take place at the European level for genuinely cross-border activities or systemic market infrastructures, but the right balance must be found. There should be clear criteria for conducting supervision at the European level. There should also be a single entry point for third-country players into the EU, which is not the case at present. The regulatory and supervisory framework must also become more agile to allow quicker adjustments to market evolutions.

3.4 Developing securitisation

An official emphasised that strengthening the securitisation market is a key success factor of the CMU agenda. There are many hurdles to clear, including the prudential treatment of different products and insolvency laws, that we should aim to lower during the next European mandate. A public guarantee for such products at the European level could also kickstart the market and lead to an examination of the other obstacles that are hindering the development of these products.

An industry speaker agreed that a renewed focus on securitisation would be welcome. Securitisation partly explains why two-thirds of the financing of US companies comes from capital markets, compared to one-third in Europe.

3.5 Achieving a more harmonised regulatory framework

An industry speaker stated that bold moves are needed in the future steps of the CMU to achieve a truly harmonised regulatory framework and to avoid local gold-plating. Reaching the endpoint of full integration will take time and require significant political will, but this is no reason to delay ambitious harmonisation actions that can support a progressive integration of EU capital markets.

A second industry speaker agreed, noting that work should continue on longstanding barriers to further integration such as insolvency law or withholding tax. A third industry speaker suggested that implementing a depository passport should also be a key objective on the future CMU to-do list. The lack of a depositary passport is particularly a hurdle for smaller countries. Restrictions on the location and provision of collateral are a further issue to tackle.

A policy-maker emphasised the importance in the future steps of CMU of distinguishing between actions that must be taken anyway, such as reviews of existing capital market legislations, and more fundamental reforms needed to build a single market in the areas of taxation, accounting, corporate law and supervision, on which more work is clearly needed.

4. Approach going forward

Suggestions were made by the panellists on new ways to approach the CMU in the next political cycle.

4.1. The need for a strong narrative around the financing of the EU economy

A policy-maker stated that CMU does not need a fundamentally new approach. It is necessary to increase political buy-in and ambition around the project and to effectively implement the actions that have been adopted. Developing a convincing political narrative around CMU is essential. Without it, the necessary political commitment will not be achieved. There should be more focus on the ultimate objective of CMU, which is to increase the direct financing of innovation in the EU and to support economic growth, rather on the CMU itself. The Eurogroup initiative and the upcoming Letta and Draghi reports provide a unique political opportunity to seize the attention of the European Council on CMU.

While it would be helpful to evaluate the potential impact of CMU on economic growth with more detailed economic analysis, such an evaluation would be difficult and time-consuming, the policy-maker felt. Gathering factual evidence by talking to issuers or investors who operate in the US market for example seems preferable to additional academic research. It is important to show that issuers are listing in the US because they get a higher valuation and can access a readymade ecosystem. This may help to convince political decision-makers in Europe that there is a slow-burning crisis underway. The EU capital market is falling behind other parts of the world and its share of global markets is shrinking. These are the arguments that need to be put forward to develop a proper narrative.

A public representative agreed that no significant progress can be made on CMU unless it becomes a priority for the Council and member states. This requires a more ambitious and convincing narrative around CMU so that politicians understand its importance and the implications for citizens, firms and the single market. The new Commission and Parliament will need to build this new narrative and it is hoped that the upcoming reports from E. Letta and M. Draghi will be helpful in this regard. The CMU project must not be viewed as a set of technical measures, but as a fundamental initiative aimed at enhancing financing options for European SMEs. These businesses should be able to access adequate capital through equity markets, reducing their reliance on traditional bank loans. Furthermore, the broader implications of CMU for EU citizens, particularly how it influences long-term investment opportunities and the linkage between pensions and CMU, deserve thorough consideration. This holistic approach will ensure that CMU's benefits are fully realized, fostering a more robust and integrated financial landscape across Europe.

An industry speaker agreed on the need for an aspirational objective to mobilise people around the CMU. The original single market project created a strong mobilisation. Businesses adapted their planning based on the expectation of future success of the single market, thereby creating additional momentum. So far, the CMU project has not managed to create such an effect. In order to make significant progress on the CMU, there must be a theme that can act as a flag around which people and businesses can rally.

Another industry speaker suggested that the CMU is essential for bolstering the evolving ambitions of the single market. Initially, the single market's primary aim was to foster a more integrated internal market by lifting barriers. There are now new dimensions to the single market, such as supporting the sustainable and digital transition of the EU economy and the open strategic autonomy agenda aiming to reduce dependencies. These new dimensions require the single market to facilitate three core transitions: sustainability, digitalization, and increased self-reliance. The CMU, together with the Banking Union, should aim to provide the financing tools needed to achieve these goals and adapt the ambitions of the single market in an evolving global landscape.

An official noted that political will is important but not sufficient. The Banking Union benefited from a major political drive at its outset and has still not been achieved. Developing a narrative for CMU and adopting an effective method of implementation is key. Much progress has been made in many areas of the capital markets framework in the last few years, but what we are trying to achieve with CMU and what CMU precisely implies is still unclear. There should be more focus on a set of priorities and transformative initiatives that are likely to support the financing of the economy.

4.2 Mobilising the different components of the ecosystem towards a common CMU objective

A regulator emphasised the importance of action at different levels and moving in a common direction to progress on CMU. Key political decisions must be made at the European level, but member states must also look at relevant aspects at the domestic level. The market, including citizens and firms, must also be further mobilised around the objectives of CMU and provided with the tools to take advantage of the single capital market. There are significant savings in Europe, but they are currently not employed in a productive way. Households need better opportunities to grow their money. Private pension and workplace schemes need further development to provide the long-term capital needed to fund the economy, while also offering more attractive long-term investment opportunities. This is a key societal objective. Market fragmentation must also be reduced so that companies can find capital across Europe more easily. Europe must also remain open, attractive and competitive as a capital market.

A policy-maker stated that a change of approach is needed in both the private and public sectors. Vested interests must stand aside. An integrated market cannot be regulated into existence. EU legislation removes obstacles to integration, taking away differences in national legislation and replacing them with a single law. It is then up to the industry to take advantage of that single law to further consolidate and integrate. There will be relative winners and losers in the CMU process. If players in the market are unwilling to accept that competition may increase as a result of further market integration and that business models may need to adapt to these evolutions, then CMU will fail, regardless of policy actions taken at EU or domestic level. One option for mobilising the different components of the ecosystem is to combine the top-down EU-level legislative approach with bottom-up action at member state level in areas such as taxation and pensions, where they have competence. However, action at member state level should be conducted in a way that does not prejudice the outcome of a single market and lead to more fragmentation, requiring coordination at EU level.

An industry speaker agreed that CMU cannot only be about top-down initiatives. Strong local capital markets are also needed and there is a role for the national authorities and the private sector in developing them, such as by setting out concrete initiatives that are relevant to a given market. This was done in Italy for example by the local ecosystem and can be replicated in other EU countries, alongside the implementation of a unified top-down EU framework.

A public representative emphasised that connecting the different parts of the ecosystem also requires a connection between CMU and the Banking Union and achieving the Banking Union. To do that, progress is needed on the European Deposit Insurance Scheme (EDIS). Providing tax incentives is also important to encourage the participation of actors in the capital markets, but no lasting and significant progress will be made on CMU without moving towards single supervision, facilitating an effective dialogue between national and European supervision, and creating a market environment that fosters the participation of retail investors and SMEs and a strong connection with the Banking Union. All those elements are needed for making the CMU a political priority that can deliver real progress.

Another industry speaker stated that the question is not whether a top-down or bottom-up approach is needed, but rather whether it is possible to create a system that companies, issuers, investors and citizens truly endorse. Capital markets do not only exist to finance the economy, completing bank and public financing and monetary policy actions, but also to allow citizens to participate in value creation and in the wider economy, ultimately strengthening democracy.