CMU future steps: main proposals

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1. Renewed momentum for CMU but limited growth of EU capital markets

1.1 Increased political support for CMU as a new European cycle begins

As a new political cycle begins in Europe, there is a renewed and growing momentum around the Capital Markets Union (CMU) initiative.

Support for the CMU has been clearly expressed by the French President and the German Chancellor in a joint article published in the Financial Times in May 2024, following a similar op-ed by the German and French finance ministers in September 2023. Additionally, an initiative led by the Eurogroup President in 2023 resulted in a statement on CMU published in March 2024, endorsed by all Eurogroup Ministers[1], demonstrating the strong commitment for CMU at the Eurozone level. This statement also includes a detailed action plan outlining future steps for the CMU. The prominent focus on CMU in the Letta report on the single market[2] further highlights its importance on the EU political agenda, and the CMU is also expected to be a key theme in the upcoming Draghi report on EU competitiveness.

Moreover, a significant number of contributions and reports published by EU and national authorities, industry representatives and think tanks in 2023 and 2024 – including, among others, ESMA's position paper on CMU (May 2024), the proposals of the French Ministry of Finance for a Savings and Investments Union (April 2024), and a joint report from AFM and DNB on the next steps for CMU (February 2024) – reaffirm support for the CMU's objectives and outline priorities for its next steps. These reports primarily address three main areas: the rationale for the CMU, the key actions required to achieve it, and the most effective approach to implementing these actions.

1.2 Slow progress in European capital market growth so far

However, nine years after the launch of the CMU initiative, the general perception in the market is that while the CMU has led to significant advancements in the regulatory framework, it has fallen short in fostering growth or integration of European capital markets. European markets continue to be underdeveloped relative to the economy's size and remain fragmented along national lines. Some scepticism therefore remains about the initiative's ability to drive a significant expansion of European capital markets going forward, if there is no significant change in the way the CMU project is led.

This limited progress in terms of market growth enabled by CMU is attributed to several factors including the slow EU legislative process, the watering-down of some measures proposed by the Commission due to insufficient political backing behind the project and vested interests at industry and member state levels, the persistence of fragmented legal and fiscal frameworks that hinder further integration and the multiplicity of key areas for the development of European capital markets outside the direct competencies of the EU (such as taxes, pensions, financial education, etc.).

The under-development of European capital markets can be measured through different indicators including the size of markets relative to GDP, the funding mix of firms and the size of available funding pools[3].

The size of European capital markets relative to GDP has not grown significantly in recent years, with the gap widening with the US and some APAC countries. At the end of 2021, EU debt securities and public equity markets represented 233% of GDP, half the size of US markets at 449% of GDP, with the main difference coming from equity markets. In addition, the EU's share of global capital market activity fell by over 40% between 2006 and 2022,

1. Eurogroup statement on CMU, March 2024.
2. Enrico Letta Report on the Single Market, Much more than a market, April 2024.
3. See Eurofi note 'Update on the progress made with CMU', Eurofi Regulatory Update, February 2024 for sources, further detail and additional statistics www.eurofi.net/wp-content/uploads/2024/03/eurofi_update-on-the-progress-made-on-cmu_ghent_february_2024.pdf

now representing only 10% of the global market, compared to a share of global GDP of 19%.

In terms of funding mix, EU non-financial companies (NFCs) still rely heavily on bank lending, which constitutes 76% of their corporate borrowing compared to just 27% in the US, with tradeable assets like debt securities and listed equity accounting for only 26% of their overall funding in 2022, much lower than in the US (68%), the UK (42%) and Japan (48%). Additionally, the share of EU NFC's funding derived from bond and equity issuance dropped to 10.3% in the first half of 2023, down from an average of 11.5% between 2016 and 2019, and IPO issuance volumes have significantly decreased.

Moreover, EU households' participation in capital markets remains low with 30% of their financial assets held in currency and bank deposits in 2021 compared to 12% in the US, and only 25% in securities compared to 45% in the US. The total size of EU financial assets likely to be invested in the capital markets is also significantly smaller, representing 254% of GDP in the EU compared to 553% in the US and 339% in the UK in 2022, due in particular to lower pension assets. The size of household financial assets relative to GDP (excluding cash, deposits and unlisted securities) is also much lower than in the US and UK (90% compared to 182% in the UK and 310% in the US in H1 2023.

Finally, European capital markets vary significantly in development, with strong markets in the Nordics and some Western European countries, and very limited markets in many Southern and Central Eastern European (CEE) countries. They also remain fragmented along national lines, which limits their efficiency, liquidity and depth, with persistent home bias in the detention of equities and bonds and in the issuance of equity[4]. Recent data shows that 70% of equity investments by EU investors remain within their home country and cross-border equity issuance in the EU accounts for only about 15% of total issuance[5].

2. Proposals made for the future steps of CMU

The reports published on the future steps of the CMU and the Letta report collectively present a broad range of actions aimed at further developing capital markets in Europe. While many of the themes from previous CMU action plans reappear, new ideas have also emerged, such as the introduction of improved European long-term retail investment products or new product labels, tax incentives for retail investors, and the creation or consolidation of exchanges focused on specific market segments (SMEs, tech) at EU level. There is also a greater focus than in earlier plans on fostering digitalisation and on the interactions between capital markets and sustainable finance. Additionally, some reports demonstrate a higher level of ambition compared to previous recommendations in areas such as securitization, supervision, and the harmonization of legal requirements.

The proposals made in these reports cover 7 main areas:

1. **Enhancing EU level supervision and rulemaking:** The improvement of EU capital markets supervision is highlighted in most reports as an important step towards advancing market integration, ensuring consistent regulation, and promoting financial stability. However, stakeholder views differ on the extent of and approach to such integration.

   Suggestions range from progressively increasing EU-level supervision of significant market participants and cross-border activities to simply optimizing existing coordination mechanisms. A review of the European Supervisory Authorities (ESAs)'s governance arrangements is also proposed to better align them with the needs of an increasingly integrated market, as well as a centralisation of certain supervisory data collection and processing activities at the EU level to enhance consistency and efficiency. Additionally, measures to improve rulemaking are proposed to maintain consistency and agility with faster evolving capital markets. These measures include the introduction of no-action letters, adopting a more principles-based legislative approach in areas that are rapidly changing and a systematic use of regulations.

2. **Reviving the EU securitisation market:** Proposals are put forward to revive securitisation, as a means to enhance banks' lending capacity, improve risk distribution, and support the development of new asset classes. Despite previous efforts, including the introduction of the Simple, Transparent, and Standardised (STS) label, the European market has not gained traction.

4. A growth of cross-border investment fund volumes within the EU has been observed however over the last few years and cross-border bond issuance is quite high.
5. Source ESMA 2023 data on cross-border investment activity of firms. 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.

Suggested measures include a review of the prudential treatment of securitisation for banks and insurance companies; an improvement of reporting and due diligence requirements; and the introduction of public guarantees for certain segments such as green securitisations. The creation of a European platform for issuing and guaranteeing securitisations with standardised processes is also proposed, particularly for green securitisations, in order to reduce costs and enhance the scalability of EU securitisation activities.

3. **Improving long term retail investment products and related incentives:** Proposals are made to enhance long-term retail investment products in the EU with the aim of more effectively utilizing retail savings to support the European economy and address the pension gap.

   These proposals include the creation of a new European retail product label or of improved long-term savings products to encourage retail investment and the development of private pension markets. The enhancement of tax incentives is also proposed, with the objective of encouraging Member States to implement consistent and favourable tax treatments for long term retail investment across the EU. Additional measures focus on increasing retail engagement and improving investment outcomes, such as promoting financial literacy, supporting the digitalization of investment solutions, and enhancing financial advice and financial health checks.

4. **Further integrating EU securities markets:** The further integration of European capital markets remains a key objective in the reports on CMU, with a focus on addressing challenges related to fragmentation in regulatory frameworks that limit cross-border capital flows and economies of scale and encouraging the further integration of market infrastructures.

   To address these issues, the European Commission is encouraged to pursue the harmonisation of securities clearing, settlement, and collateral management rules. Additionally, there is a call to promote greater convergence in insolvency laws, tax processes, and securities laws that impact cross-border securities transactions. Other suggested initiatives include the creation of EU-level exchanges for smaller market segments, such as SME and tech markets, to enhance liquidity and market visibility, as well as the development of a digital CMU for tokenised assets.

5. **Stimulating equity funding:** Developing equity markets is a key objective of previous CMU action plans aimed at supporting the financing of innovative businesses in high-growth sectors such as technology and green industries, and reducing reliance on debt.

   Measures include the Listing Act and the European Single Access Point (ESAP). The Debt-Equity Bias Reduction Allowance (DEBRA) proposal, although currently paused, is also identified as an important measure for creating a more balanced approach between debt and equity financing. Additional actions are suggested to improve the financing of firms throughout their lifecycle, including exchanges of best practices across EU member states and measures to strengthen the funding of scale-up firms, which often seek financing outside the EU. These letter proposals build on initiatives such as the European Tech Champions Initiative (ETCI) established by the European Investment Fund (EIF).

6. **Supporting green and digital investments:** A key objective highlighted in recent reports on CMU is to support the digital and green transitions while positioning the EU as a global leader in sustainability and innovation.

   Proposed measures include promoting public-private partnerships for green infrastructure, enhancing the EU sustainable finance framework, and developing green finance hubs. The proposals also emphasize the importance of fostering digital innovation within the financial sector, particularly through the increased adoption of blockchain and distributed ledger technology (DLT), with the broader goal of creating a digital CMU potentially based on a common infrastructure for digital assets.

7. **Developing private pensions in the EU:** In response to the growing pension gap in the EU, driven by a rapidly aging population, there is a strong push to develop private pension systems.

   Proposed measures include promoting auto-enrolment schemes and relaunching the Pan-European Personal Pension Product (PEPP), with recommendations to simplify the product, improve its tax treatment, and provide more flexible investment options. These proposals are completed by calls for better digital tools and platforms dedicated to pensions, such as pension tracking systems and dashboards, to increase awareness of pension issues and to facilitate the management of pension schemes by EU citizens. Finally, there is an emphasis on improving financial literacy and enhancing tax incentives to foster long-term investment in private pension products.

3. Additional areas of focus for the next steps of CMU

3.1 Completing the narrative around CMU with a shared vision and strategic direction for CMU

The need for a more convincing and appealing narrative around CMU that may encourage political decision makers, regulators and industry participants to drive the project forward is emphasised by many observers. Indeed, CMU cannot be an end in itself and must serve specific needs of the EU economy and society. As much of the 'low-hanging fruit' has already been addressed, the project now requires a more aspirational and forward-looking narrative to drive it forward and tackle the more structural and contentious issues that have been previously sidelined to a certain extent.

The reports recently published on the future steps of CMU provide a strong narrative about the rationale for CMU, highlighting its importance for the European economy and the potential benefits larger and more integrated capital markets may bring. They emphasize the critical role of capital markets in driving innovation, economic growth, and supplementing bank and public financing in the EU to provide the significant investments required for the green and digital transitions, estimated at over €620 billion annually. The further integration of EU capital markets enabled by CMU would reduce funding costs and make markets more attractive for issuers and investors. Several reports also note the importance of better utilizing European citizens' savings, currently largely invested in bank accounts, to fund EU capital markets and improve long-term returns for savers. Some commentators however argue that increasing retail participation alone may not boost funding for European firms, unless specific measures are put in place to direct investments to these firms, since a large part of savings may be invested outside the EU to boost returns and increase diversification.

At this stage, however, there is no shared narrative on the final form the CMU should take or the pathway to achieve it, which may involve successive intermediary stages of development. To build a more concrete and compelling narrative – and to better prioritize the key drivers and actions for the next steps of CMU – a more precise formulation of the objectives of CMU is needed, particularly in two areas.

A first area is determining the financing model that we are aiming for in Europe in terms of balance between capital market and bank financing and how to transition from a predominantly bank-financed economy to a more diversified funding model, which also requires a reflection on the synergies between the CMU and the Banking Union[6]. Although the US capital market is used as the main benchmark, several structural differences between the EU and the US – such as the fragmentation of legal frameworks in Europe, the dominance of pay-as-you-go Pillar 1 pension systems, the smaller size of SMEs in Europe on average, the diverse maturity of financial markets – make it challenging for the EU to fully replicate the US model, even in the longer term. Therefore, a distinct European financing model must be developed that combines capital market and bank financing and builds on the complementarities between the two, also considering the variability in financing needs across EU Member States.

A second aspect concerns the degree of integration that needs to be achieved to develop European capital markets and the target model of a more integrated CMU – *e.g.* a fully integrated EU capital market or an interconnected network of financial centres or regional markets and ecosystems across Europe – as well as the implications of such integration on market structure. Further thought is also needed on the degree of priority of this objective compared to the growth of domestic or regional markets, given the challenges raised by the lifting of

6. One question is the extent to which a further integration of the banking sector is essential for the CMU. Currently, the Banking Union is at a standstill, which perpetuates the fragmentation of the European banking sector. However, considering the central role that banks play in capital markets—for activities such as in primary issuance, trading, market-making and investor intermediation—significantly growing and integrating European capital markets seems challenging without a more integrated banking sector.

legal and fiscal barriers to integration. Indeed, while the further harmonisation and integration of capital markets is essential for wholesale and institutional markets and sophisticated retail investors, mainstream retail and SME markets can develop to a certain extent at a domestic or regional level, particularly in the countries where they are non-existent at present[7].

These aspects are quite challenging to define and agree on upfront, given the diversity of needs and interests across the EU. However, with the benefit of hindsight from the initial action plans, building a narrative around the vision and strategic direction for CMU in terms of financing model and level of integration is essential to drive the next stages of the project.

3.2 Issues to further consider in the next steps of CMU

Despite the broad scope covered by the reports on the future steps of CMU, three issues may require further consideration in the actions proposed.

A first issue is the interaction between bank and capital market financing and the measures needed to support a transition from a predominantly bank-centric economy to one where funding is more evenly balanced. Several elements must be further specified, including how banks can contribute to this shift and bridge the gap in terms of capital provision until capital markets are more developed (*e.g.* through bank-funded investment initiatives like the BGF fund in the UK[8]) and how the business models of banks should evolve to adapt to a more balanced financing mix (*e.g.*, if a portion of retail deposits is redirected into capital markets). Clarifying the role that securitisation may play in developing synergies between bank and capital market financing is also essential. Securitisation can indeed help to increase the lending capacity of banks, as well as contribute to the development of capital markets by transforming lending portfolios into investable securities and therefore may play a key role in the synergies between bank and capital market financing[9].

A second important aspect to consider in further steps of the CMU is the impact of the competitiveness of the European economy on the development of capital markets. A key factor driving EU investments to the US, for example, is the higher returns that investors can obtain, which stem not only from the greater size and liquidity of US markets but also from the differences in productivity, profitability, and overall competitiveness between the EU and US economies and firms. This competitiveness gap has significant implications for the growth and development of European capital markets. However, addressing it requires structural reforms that extend beyond the scope of the CMU.

Open strategic autonomy is a third important aspect to consider. It underpins several CMU proposals, such as directing more retail savings into the EU economy and retaining scale-ups within Europe. However, these goals may create trade-offs with market development objectives. For instance, directing retail savings to EU firms might conflict in the short term with offering higher returns to savers. Additionally, further integration of European capital markets could benefit foreign players, highlighting the need to enhance the competitiveness of European financial institutions to preserve strategic autonomy. Explicitly considering open strategic autonomy issues in CMU decisions could help balance these trade-offs and challenges more effectively.

4. Approach for further developing EU capital markets: a top down or bottom up approach

Another important aspect is determining how the CMU should be conducted and implemented going forward. A key question is whether the CMU should adopt a top-down or bottom-up approach. The top-down approach emphasizes harmonizing regulations and implementing EU-level frameworks driven by EU institutions, while the bottom-up approach aims to leverage existing best practices and build more on existing financial centres and ecosystems with coordination at the EU level. Related to this debate is how the decision-making process around the CMU action plan and its implementation should be conducted: *i.e.* whether an up-front commitment from EU institutions to CMU objectives and priorities should be favoured, or if efforts should be made to

7. This leads to questioning whether priority should be given in the CMU to the development of wholesale markets, which are likely to enhance the liquidity, depth, and scale of European markets, or whether the primary focus should be on retail investment and SME funding, as suggested by the proposal to rename CMU as a 'Savings and Investments Union'. While both objectives must eventually be achieved, as they are mutually reinforcing, clarifying the strategy for the development of capital markets in these two areas and how they may complement each other, would help to build an effective action plan and strengthen the narrative around CMU. Previous CMU action plans combine actions to develop retail and SME markets such as the Retail Investment Strategy, the Listing Act and actions that may benefit more wholesale markets like the MiFIR review with measures including consolidated tapes, but this has not been done in a explicit way and is not reflected in the narrative around CMU.

8. See Eurofi Views Magazine September 2024 James Chew, HSBC.

9. See Eurofi Paris Summary February 2022 How can banks contribute more to the CMU?

build consensus among member states in a more bottom-up manner[10].

Recently, there have been several calls for a top-down approach to CMU, with a strong focus on integration and harmonisation. Proponents argue that EU-level initiatives – such as implementing a unified rulebook and establishing a single capital market – are essential for financing innovation and addressing challenges related to the green and digital transitions, which are common objectives across all EU Member States. Broader capital markets are indeed essential in their view to allow innovative firms to have access to adequate financing, necessitating greater harmonization and integration efforts. Additionally, integrated markets can lower financing costs for all firms and enhance private risk-sharing across the EU.

For example, in November 2023, the ECB President called for a "Kantian shift" towards a more top-down CMU approach[11], highlighting the need for a European SEC to enforce a unified rulebook and for a consolidation of market infrastructures at EU level. Additionally, in June 2023, the IMF Managing Director emphasized the importance of the "Union" aspect of the CMU[12], advocating for a single access point to disclosures and information at EU level[13], rule harmonization (including corporate insolvency), supervisory convergence, and the creation of interconnected clusters of expertise across the continent, rather than multiplying separate domestic financial centres.

However, CMU measures must also address the diverse needs of EU Member States, particularly concerning SME financing and retail engagement, while promoting capital market development in countries where markets are underdeveloped. The CMU approach must also allow for an effective exchange of best practices in a context where domestic markets vary widely in maturity. Bottom-up approaches are necessary to meet these varied needs, but the goal should be to support progress toward common objectives and rules, albeit at a pace adapted to the maturity levels of different markets, which requires appropriate EU-level coordination. This is consistent with the approach recently endorsed by the Eurogroup, which published a statement on the future of CMU after consulting Eurozone finance ministers and industry representatives. A list of 13 actions was proposed, with a strong focus on the further convergence and harmonization of existing rules and processes, the sharing of best practices and an effective allocation of responsibilities between the European Commission, Member States and the industry for their implementation.

For future stages of the CMU, a balanced approach combining top-down actions with the flexibility to adapt to the specificities of individual member states and their markets will likely be needed[14], capitalizing on the complementarity of these two strategies. While a bottom-up approach fosters consensus and builds on existing best practices, merely developing domestic markets and integrating them bottom-up through harmonization efforts may fall short, even with effective EU-level coordination. Separate domestic markets and national specificities may persist, hindering the creation of large, efficient capital markets in Europe. Therefore, a top-down approach is also needed to achieve a single capital market over time – featuring common European rules and procedures[15], consistent enforcement and supervision across the EU, and single access points to the EU market – combined with coordinated efforts to ensure all Member States progress toward a common objective[16].

10. 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 institutions. 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. Source: Final Report of the High Level Forum on the Capital Markets Union – June 2020.
11. Speech by C. Lagarde at the European Banking Congress, 17 November 2023 'A Kantian shift for the Capital Markets Union'.
12. IMF Managing Director's remarks on strategic priorities for the European capital markets, 15 June 2023.
13. This has been implemented with the European Single Access Point measure (ESAP).
14. See AFM and DNB report on the next steps for the CMU, February 2024.
15. Including notably common capital market rules, common key corporate laws for the capital market, common tax procedures to avoid double taxation.
16. See contribution by J. Berrigan to the Eurofi February 2024 Views Magazine for example.