CAPITAL MARKETS UNION: FUTURE STEPS

VERENA ROSS
Chair – European Securities and Markets Authority (ESMA)

Picking up the pace in building EU capital markets

Well-functioning capital markets enable citizens and companies to reach their financial goals and realise their dreams. This can be about building an innovative start-up into a blue-chip company, creating wealth and employment in the process. It can also be about parents saving for their children's future, saving for retirement or investments making it possible to buy a home. While, in recent years, the CMU agenda has led to gradual progress in improving efficiency, scale and resilience, European capital markets still remain largely underdeveloped and fragmented. At this juncture, given squeezed budgets and the need to support the green and digital transition, there is an urgent need for more market-based finance to support European competitiveness in a challenging geopolitical landscape. It is in this context that the European Council has called to accelerate work on deepening the Capital Markets Union and Ursula von der Leyen has committed to push forward with a European Savings and Investments Union.

At the end of May, ESMA published its position paper on "Building more effective and attractive capital markets in the EU". In the paper, we outlined 20 recommendations to strengthen EU capital markets and address the needs of European citizens and businesses. The publication was the culmination of the work of an ESMA Board-level Task Force which analysed the functioning of capital markets from a national and EU perspective, considering regulatory, market and international developments. The recommendations focus on three key areas: EU citizens and investors, EU companies and the EU regulatory and supervisory framework. To ensure citizens can save effectively for their future needs, including through pension plans, they need to have access to simple, cost-efficient investment options. EU companies need funding that enables them to grow and innovate, creating jobs, growing the economy and promoting European competitiveness. Underpinning all of this is the regulatory and supervisory framework, ensuring that markets are transparent and fair, that they are resilient and operate with integrity. A regulatory framework needs to stay abreast of market developments and innovation. Based on our experience, we consider that the EU's regulatory framework should be modernised to make it simpler and more agile, allowing for faster action when so required. We also need to work to improve supervisory consistency and in certain cases evaluate the case for direct supervision at EU level. Where local knowledge is key, national authorities remain best placed to carry out supervision. However, where entities operate with a cross-border, pan-European model, such as large pan-European market infrastructures or crypto asset service providers, the benefits of EU-level supervision should be considered.

There is an urgent need for more market-based finance to support European competitiveness.

Europe is at the vanguard of regulation in the digital space. Regarding cyber security and crypto-assets, ESMA, together with our ESAs colleagues, have been given mandates through DORA and MiCA and measures are currently being taken to prepare for their application. Moreover, we are closely following other market developments, for example in relation to the role of finfluencers and the use of AI. To develop our European capital markets, we should make use of technological advances, in full consciousness of the opportunities and challenges they bring. Digital solutions can support retail investors' participation in capital markets, making them more inclusive and accessible and empowering citizens in their investment journeys. This is why, in our position paper, we call for supporting investor friendly innovation, promoting interactive financial education and incorporating safe and suitable investor tools. Similarly, technology can help EU companies to effectively engage with investors, reduce reporting burdens, facilitate automation of processes and overall free up resources and increase efficiency. While conscious of the benefits that new technologies can bring and supportive of their safe deployment, as regulators and supervisors we need to keep up to date, monitor developments and build capacity to deal also with the risks such innovations may pose.

There is a lot to be said for step-by-step progress, indeed you need to be able to walk before you can run, but hopefully by sharing experiences, knowledge and expertise we can pick up the pace and move forward together in building EU capital markets that are fit for the future. At ESMA, we stand ready to do our part in supporting these efforts.

JURAND DROP
Deputy Minister of Finance, Poland

Reframing the EU's Capital Markets Union: balancing regulation and innovation

The Capital Markets Union (CMU) project was launched almost a decade ago due to the lingering effects of the global financial crisis on the European economy. Additionally, the value of capital flows between member countries was low, and Europe's capital market-based financing was underdeveloped compared to other parts of the world. To achieve integrated capital markets in the Union, the Commission published two action plans for the creation of the CMU (in 2015 and 2020), each consisting of several legislative initiatives aimed at significant progress in CMU introduction. Most of these initiatives have been implemented, yet financial integration indicators have not increased, and the expected rise in transnational market transactions has not occurred.

Therefore, it seems obvious that the CMU objectives need to be reframed. However, the direction of the changes is not yet known. The discussion about the CMU's further development in the next European political cycle is underway, involving various stakeholders. Everyone is contemplating how to improve European capital markets and secure funds for necessary digital and green transformations. New reports keep emerging, but the same ideas are often repeated, indicating a need for fresh perspectives and innovative solutions to these longstanding issues.

Many of these ideas are valid: developing the European securitisation market, ensuring targeted convergence of national corporate insolvency frameworks, and further harmonising accounting frameworks. However, the most evident feature of the EU regulatory system—its overregulation—is often overlooked. While proper regulations enhance investor confidence, overly complex ones can be counter-productive. The EU's regulatory complexity disincentivizes investment and diverts resources away from innovation towards compliance. Extensive documentation demands consume company resources that could be better spent on productive work, innovation, and market competition. It's crucial to acknowledge that investing involves risk, and a risk-free Capital Markets Union is unattainable.

Therefore the incoming Commission should focus on assessing the feasibility, impact, and effectiveness of existing legislation before proposing new requirements. Measures to reduce regulatory burdens in the EU's financial market framework, particularly for smaller participants, should be prioritized. Any new legislative initiatives should always be based on thorough impact assessments to ensure they do not add unnecessary complexity.

Even with effective tools to deepen European capital markets, changes won't happen overnight. It will take years for the introduced changes to bring results, while the financial needs for digital and green transformations are immediate and pressing. This reality suggests that the hopes placed on the CMU might be too ambitious and need a more grounded approach.

Additionally, the EU should reconsider the banking sector's role. Instead of aiming to replace banks with capital markets, the focus should be on the synergies between them. Banks are significant capital market participants as service providers, issuers, and investors, and they remain active intermediaries in securities issuance and sales of securities. Capital markets also collaborate with banks, especially in credit-related activities, securities financing transactions, providing collateral for OTC derivatives, and repo transactions. These synergies indicate significant mutual relations between the banking sector and capital markets.

Therefore, the EU should leverage these synergies rather than overlook its banking sector. The CMU should be considered in the medium or long term, with a focus on market development. A contingency plan is also essential in case the CMU actions don't meet expectations for financing green and digital transformations. This approach does not undermine the CMU idea but highlights the need for the EU to be prepared for various outcomes.

EU should reduce regulatory burdens and leverage bank synergies to improve capital markets.

This means the EU should not forget its banking sector but rather harness the synergies between credit and capital markets. By recognizing the interconnectedness and mutual benefits, the European Union can better navigate the complexities of financial market integration and address immediate funding needs. The CMU remains a valuable goal, but the strategy must be adaptive and realistic, considering both short-term and long-term perspectives. Effective integration of banking and capital markets will ensure a robust and resilient financial system capable of supporting Europe's economic and transformative goals.

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Paving the way for an ambitious CMU agenda

The past year has allowed for significant progress in the discussions on the Capital Market Union initiative. The sense of urgency to finance adequately the European economy, including through the massive investments required to support the green and digital transition, is now widely shared. The approach followed since 2015 has brought some incremental progress but will not be sufficient to strengthen significantly the depth and liquidity of European Capital Markets.

Both the Noyer and Letta reports, as well as the April 2024 European Council Conclusions, the ECB Board of governors' April 2024 statement and the ESMA June 2024 position paper sent converging messages, calling for significant progress on several key issues including supervision, securitization and savings products.

The Noyer report, published in April, formulated concrete recommendations on 4 main themes: integrating the supervision of capital markets activities, relaunching Europe's securitization market, developing long-term savings products and addressing the fragmentation of post-trade infrastructures. Beyond the usual adjustments of the EU's financial services regulatory framework, these proposals can transform significantly the financing conditions of European companies.

The relaunch of Europe's securitization market has benefitted from a wide support by political leaders as well as private institutions. It is now identified as one of the next Commission's key priorities. In this regard, we welcomed the announcement of an upcoming consultation this fall. It should cover both the prudential and regulatory adjustments needed in the short-term, and explore the suggestion formulated in the Noyer report of designing a common issuance and guarantee platform. A legislative package in late 2024 or early 2025 will be pivotal to enable the targeted adjustments required on the regulatory and prudential aspects. Longer discussions could be needed regarding common platform.

Substantial adjustments to the EU's financial supervision architecture are also warranted, and have received a broad political support in the past months. These adjustments are motivated by the need to overcome market fragmentation, support the competitiveness of European financial actors and, ultimately, offer better financing opportunities to all EU firms.

One crucially needed reform is a more centralized supervision at the European level. Indeed, while building the single rule-book was a necessary first step, national-level supervision will always lead to differentiated interpretations of our single rulebook and therefore, fragmented markets. This fragmentation generates significant costs, both for EU citizens, who miss on cross-border investment opportunities and pay higher fees on their asset management products, and European financial actors who, unlike their US peers, are unable to rely on a deep and integrated market to generate significant economies of sales, and efficiently channel funds to support companies across the continent.

In this context, a more centralized supervision would be particularly useful for large, pan-European financial actors, which currently have to engage in bilateral dialogues with several national supervisors, often without coordination. Beginning with cross-border and systemic market infrastructures therefore seems the most suitable option. The Commission was given a mandate to explore ways forward by European leaders in the April 2024 European Council conclusions. A thorough preparatory work is required without delay, and reflections around the adjustments required for ESMA's governance and architecture will have to be conducted. In particular, considerations should be made with regards to the role that national competent authorities could play, in coordination with the European supervisor, in this new architecture, in order to build on their expertise and knowledge of national ecosystems, without creating additional layers for the supervised entities. Particular attention should be given to the effects of this new architecture on smaller capital markets through the detailed impact study to be performed by the Commission.

Another key issue that will have to be addressed is the misallocation of our savings, which given their abundance (European households savings' rate is for instance notably higher than American ones), should constitute a key support to long-term development of European firms as well as innovation but are currently underutilized, being massively held as deposits or invested in the US.

To correct the current misallocation, the Noyer report suggests the creation of a European Savings Product label through an inter-governmental approach, aimed at channelling more adequately our vast pool of savings towards the long-term financing of Europe's economy. It identifies several fundamental principles or criteria which should be integrated within the label, including a predominant allocation in European assets, a long-term investment horizon, no permanent capital guarantee, an attractive tax regime and a managed allocation by default.

The Noyer report also pointed to post-trade fragmentation as significant source of costs for financial institutions and a barrier to more pan-European investments. Among the various ways to address this issue, the Eurosystem's settlement system, T2S could play a pivotal role.

Key priority areas are now well identified, and there is an agreement on the general approach and the need to act quickly, which is very encouraging. Now is the time to focus our work on the concrete implementation of these existing proposals. The contribution of European industry participants will be crucial, notably through the various consultations to be launched in the coming months.

VALÉRIE URBAIN

Chief Executive Officer –
Euroclear S.A.

Activating the drivers of market growth and integration

As we begin a new European political cycle, I believe two areas of focus should be prioritised in the next five years. These are the need to support business competitiveness, particularly in strategic sectors, and the expansion of European capital markets to meet the major financing needs of the coming years.

Attracting issuers and investors - key to expanding market capacity

Successful capital markets are driven by the participation of the end-users. Europe must continue to enhance the incentives to turn savers into investors and borrowers into European issuers. Increased participation generates greater depth and liquidity, leading to more attractive conditions for investment and capital raising.

Companies and investors need to benefit from cost effective regulatory frameworks, the scale of the single market and appropriate public support mechanisms. The recent reports and analyses by leading European figures, authorities, think tanks and stakeholders have provided an extensive body of recommendations. European authorities and Member States should move quickly to target the most impactful measures to advance competitiveness across the main economic sectors. A pressing priority remains the problem of undersized risk capital pools and a limited retail investment base in parts of Europe. Retail investors need simple and inexpensive products, with appropriate tax treatments. At the institutional level, we should lift any undue biases against listed and non-listed equity investments.

It is also important to continue to foster conditions to attract external investment. As we have seen through the growth of the Eurobond market, European issuers of all types benefit from access to a globally connected ecosystem of investors.

Enhancing the efficiency and integration of post-trading

EU market integration and efficiency needs to advance across the issuance, trading and post-trading ecosystems.

Focusing on post-trading, further progress should be made in the practical integration of our architecture, guided by the need to foster scalability.

Europe already has leading infrastructures - occupying a central position in the European and global financial ecosystems - to advance this agenda.

As a starting point, reflections need to take into consideration the advances of the last decade in reducing fragmentation and promoting connectivity. They include ambitious Eurosystem projects - such as TARGET2-Securities (T2S) - which have required considerable resources and efforts.

Major industry initiatives have also been pursued. In the case of Euroclear, the integration of the leading international CSD and our network of EU and UK infrastructures have concentrated the majority of Europe's assets under custody in our group structure and contributed to generating synergies. Among the various initiatives, we have established a single settlement platform for France, the Netherlands and Belgium. Our international CSD has also been instrumental in facilitating integration in fixed income markets.

Our consolidation efforts have gone as far as the existing frameworks in the EU and Member States have allowed us. To go further - particularly in equity markets- authorities and markets participants need to work together to foster the conditions for the concentration of activity, development of cross-border flows and increased scale.

Europe already has leading global infrastructures to advance the CMU agenda.

One of the key conditions is the removal of impediments arising from national policies that prevent true competition among EU CSDs. This will require further work on legal and market convergence, as well as a rigorous application of open access and interoperability principles. Custody and asset protection regimes are still subject to widely different national approaches, thus limiting the level of potential market integration.

These obstacles are well known. Political will and consistent market efforts - not just on the part of CSDs - are needed to move forward.

Despite the challenges, I am confident that we can make significant progress building on our successes. As the leading provider of CSD services, Euroclear is ready to play its part in strengthening the European architecture to support high levels of liquidity and investment.

NIELS BRAB

Head of Group Regulatory Strategy & Chief Regulatory Officer – Deutsche Börse Group

Destination SIU: work like a gardener – the growth and competitiveness marathon

With the ambition around a new European competitiveness deal, the need to overcome structural weaknesses that make EU capital markets underperform has become an urgent task of utmost socio-economic importance. But despite a perceived fatigue after many years of hard work, we should be optimistic: The new EU legislative period and renewed political impetus offer a key window of opportunity to finally make the long-standing endeavor around the Capital Markets Union (CMU) a true success story.

Against the background of profound changes in geopolitical realities, enormous challenges around economic growth and huge financing needs, time has come to fundamentally reshape the EU's policy-approach and strategy. The first crucial step has been taken with a new vision on the horizon: The CMU's transformation towards a Savings and Investment Union (SIU).

The valuable work conducted by the Eurogroup, ESMA, Letta, and many other colleagues, has meanwhile laid the foundation to fill the SIU with lifeblood. An extensive list of game-changing ideas is on the table. What we now need to focus on is step three: Execution excellence and endurance in the marathon ahead.

After having agreed a bouquet of supply-side oriented measures during the last mandate, the focus is shifting towards a complementary set of targeted measures on the demand side – fostering a true investment culture. We should be clear: Mobilizing private capital will be key to make the SIU a success – and there are three very concrete measures that could significantly move the needle.

First, the momentum for individual savings and investment products paired with targeted tax incentives is promising – look at the success story of the Swedish ISK. Trillions of Euros continue to sit on bank deposits across the EU. Mobilizing this money towards productive investments will not only boost our economy – but also strengthen citizens' participation and democratic endorsement of the SIU.

Second, while state pension schemes should be less pay-as-you-go and more equity-oriented, we need to develop the PEPP into a true "401k EU" with employer sponsored auto-enrolled retirement accounts. Also on this end, we do not need to reinvent the wheel but simply learn from key case studies, such as in the US.

And third, we should pursue the establishment of an EU equity fund concept based on a public-private partnership under the wings of the EIB. The example of Norway shows how an equity fund can truly benefit a whole society – and the EU would not only establish a streamlined management for eligible investment and pension products in a new universe, but also send a much-needed message to global markets, i.e. the aspiration to be a competitive, pro-business marketplace that is a natural home to key capital flows and the interests of investors and issuers.

Taken together, these demand-oriented measures would inject a huge amount of fresh capital into the real economy, boost growth, create jobs, foster innovation, strengthen participation, increase tax revenues, and ultimately create a positive interplay with fiscal and monetary policy.

In all of this, we should not forget about the importance of primary markets and their ecosystems as backbone. The EU is only home to about 10% of all global IPOs and continues to suffer from a structural loss of companies that choose other jurisdictions as their preferred listing business location, a huge socio-economic damage.

We need to continue cutting red-tape for SMEs, tech and growth companies and facilitate their ability to go public. And most importantly: The EU should review its market structure vision – not only via a conversation on stock exchanges and CSDs paired with a natural empowerment of private sector to drive consolidation by reducing existing barriers, but also by reexamining the MiFID realities that have created more than 500 trading and execution venues – and with that a hyper-fragmentation of liquidity as well as a high level of dark trading.

Mobilizing private capital will be key to make the SIU a success.

The regulatory realities need to match the political ambition around deeper, more liquid and globally competitive markets. They need to incentivize investments and build on the positive case studies that other jurisdictions have successfully demonstrated – supporting the EU's ambition around a competitiveness deal, the international role of the Euro or an open strategic autonomy.

"Work like a gardener" as Miró would have put it, and remember: A rolling stone gathers no moss. The time has come to boost the CMU into a next generation of excellence SIU that delivers on our societal expectations and truly transforms EU capital markets to act as a key leverage for the global role of the EU in a new geopolitical context.

ANN PRENDERGAST
Head of EMEA, Executive Vice President –
State Street Global Advisors Europe Limited

Seizing the momentum on CMU for a prosperous and competitive European economy

Over the last year, a new political impetus has built behind the Capital Markets Union (CMU) project. A succession of high-level reports by prominent EU policymakers (former Italian Prime Minister Letta and former Banque de France Governor Noyer) and EU institutions (ECB, ESMA, Eurogroup and EU Council) have generated a rich set of proposals. All point to a fundamental reality: capital markets, and the role that the investment funds sector plays within it, are essential to build a competitive, prosperous and sustainable EU.

As announced during the first plenary session of the new European Parliament, the incoming von der Leyen "Investment-focused" EU Commission will build on these proposals over the next 5 years and focus on a European Savings and Investments Union. As the new European Commission takes shape, it is a good moment to consider the priorities for the next cycle, the proposals on the table, and the role of the funds sector in delivering on EU Competitiveness.

A competitive economy needs liquid and open capital markets

The fund sector sits at the heart of the EU economy by helping turn savings into economic growth. Households and savers secure their financial future by investing for their pension and, in doing so, savings are directed to companies and projects, fuelling economic growth. In his report, Enrico Letta rightly identifies the mobilisation of private capital as the main area where the EU is lagging behind. The report underscores a significant inefficiency in the use of the EU's economic assets, which should be better deployed in achieving the EU strategic objectives.

One note of caution, however, is that the asset management sector performs this role as a fiduciary, with the aim of achieving the best returns for households and savers. Savings are never artificially "diverted" but channelled to the best performing assets and investments, irrespective of their location. Where the CMU has so far under-delivered is in creating bridges for savings to finance economic growth and EU strategic missions. This cannot be achieved without delivering first an organic growth of capital markets in the EU, and this is something that regulation or supervision alone cannot fix.

Investor participation is about nudges, incentives and ease of access

Instead, policymakers need to focus on fostering among investors a high degree of confidence in markets and growth prospects. As ESMA points out in its position paper on CMU, domestic tax policy should be used to incentivise retail investors to participate and benefit from capital markets, while companies need to be nudged towards equity financing, corporate debt and private financing. These financing options should complement bank financing, and the revitalization of the securitization market will help bank and market-based financing reinforce each other.

More generally, the next European Savings and Investments Union should be supported by a new risk-taking culture in Europe, while safeguarding investor protection and financial stability. Here a bottom-up approach can help in socializing across the EU best practices in national markets such as the implementation of auto-enrolment or the experience with digital wealth platforms, which help bring new retail investors to capital markets. A more risk friendly culture should also extend to the way regulation is currently made in the EU, and the renewed efforts of the incoming Commission for simplification and better law making, including a new competitiveness check, are the right approach.

The time of low-hanging fruits of CMU is over, now the transformational change must happen.

Simple and long-term investment products are constantly evolving

Finally, the European Savings and Investments Union should be a call for action for the fund sector to continue evolving its product offering and adapting it to new types of investors. The UCITS brand is a strong basis from where to start and it should continue to evolve to make sure it remains relevant and able to deliver the best diversification, protection and performance to retail investors. Learning from the democratization of investments that ETFs have brought to the investing word, UCITS should continue to represent the wrapper of reference for retail investors. New labels for savings products can help, but should not limit the investment universe into which asset managers may invest.

The time of low hanging fruits of CMU is over, let's hope that with the Savings and Investments Union the EU will now engage in the transformational change that our capital markets as well as the EU economy and its citizens need.

JAMES CHEW
Global Head of Regulatory Strategy – HSBC Holdings plc

Could business growth funds be one small step for CMU?

CMU must deliver results

The focus of past CMU action plans has been legal and regulatory, creating the infrastructure to support investment and the rules to govern it. But, for all the new rules, administration and acronyms, banks remain the predominant source of finance in the EU and there has been no significant expansion in private or public equity markets for small and mid-sized companies. In this action plan, there needs to be a new approach with a greater focus on front-line delivery.

In particular, companies must be offered more appropriate equity products, with increased supply and broader deliver across different sizes of firms and geographies. And companies must be more willing to accept these investments, taking risks and fuelling growth. Some countries have been successful in this but there are many low spots across the EU. We can learn from the experiences of countries such as France, Sweden and the Baltics where long-term programmes have delivered results but there are other models worth considering.

Business Growth Funds – one small step?

One example is the business growth funds (BGFs) which have been established in the UK, Ireland, Canada and Australia. These have raised around €4bn of permanent recycling capital for minority equity investments in smaller growing companies. HSBC helped create these and provided financial support in line with its footprint.

As an example of the impact they can deliver, in the UK and Ireland, BGF has invested in over 500 companies in a range of industries and across all regions. Some businesses have failed, but the majority are successful, contributing to the economy. BGF has a current portfolio of around 350 firms with a collective turnover in excess of €6bn and employing around 70,000 people.

These BGFs offer a product which is attractive to entrepreneurs, increase the supply of finance, and deliver good long-term financial returns. They make minority equity investments, sometimes with subordinated debt, with a long-term view on realisation at a time driven by the business, not the investor.

Investments are typically between €1m and €15m, funding companies often ignored by private equity and providing follow-on funding for those backed by venture capital. They provide support through non-executive directors and BGF in the UK and Ireland has a network of 15 offices to deliver local connectivity.

They are owned collectively by the major banks in their countries, benefiting from introductions from these banks but operating independently to avoid conflicts of interest.

This separation also allows a specialised team to operate with a 'risk-on' mentality, where failures are accepted (and expected), to be offset by successes which deliver many multiples of invested capital.

They are a permanent source of capital reflecting the patient capital approach, creating an enduring intervention, recycling proceeds into new investments alongside dividends to shareholders.

They can be financially efficient vehicles for banks. Under Basel 3.1, equity investments intended to be held for more than three years will be risk-weighted at 250% and subordinated debt at 150%. As a result, the capital allocated is considerably less than the headline size of any fund. Risk-weighting and the inherent leverage in bank balance sheets then improves the return on equity, delivering reasonable results, albeit over the longer term.

Focusing leverage at the bank level, rather than in individual businesses, further reduces the risks of company failure. Banks also benefit as more equity improves their customers' appetite for risk and growth, and capacity to borrow.

These BGFs offer a product which is attractive to entrepreneurs, increase the supply of finance, and deliver good long-term financial returns.

The multi-lateral structure spreads the burden across individual banks, allowing the parties to create larger funds with diverse portfolios, lower risks and better operational efficiency. For example, a €2bn fund, supported by four banks over five years, would only require capital of €35m per bank for each of those five years.

This is not a 'grand projet' such as a pan-EU retail investment strategy. It is more national or regional scheme, executable within current regulations and focused on delivering more equity investment in smaller firms in the near term. It is a manageable proposition for banks if they are willing to work together. The Commission and governments can encourage that co-operation and institutions such as EIB and EIF might be able to help with additional financial support. It is a way in which banks across the EU can play their part, in an effective and efficient manner.