DEEPENING THE BANKING AND FINANCIAL SINGLE MARKET

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CMU and EU economic competitiveness

For the EU to maintain its competitive position in the global economy, massive investment will be required in the coming years. While the EU relies heavily on the banking sector for its financing, it is increasingly clear that a much larger share of financing in a modern economy must come via capital markets. However, the EU is currently lagging behind other major economies in terms of capital-market development. With a relatively high level of domestic savings, the EU remains a net exporter of capital. Among other things, this clearly reflects the inadequacy of the EU's capital markets in effectively channelling savings into productive investments for the benefit of EU companies and investors.

On this basis, there is an evident need for renewed efforts to create a capital markets framework that is more attractive for savings and more effective in channelling those savings to productive investment. Larger EU capital markets, which are more liquid and developed, would make the EU a more attractive place to do business for all relevant economic actors. This is the rationale that has underpinned the Capital Markets Union (CMU) project since 2014 and it will underpin further policy actions under the Savings and Investment Union.

CMU-related actions over the past decade have tried to address EU competitiveness by boosting the efficiency of capital markets. However, it is fair to say that these actions have not been entirely successful in addressing structural challenges to competitiveness linked to market fragmentation along national borders, often reflecting deep-rooted divergences in legal structures.

A priority for boosting EU competitiveness in the next legislative cycle must be more meaningful advances in CMU, which can ultimately translate into increased capital market activity on the ground. The creation of a single, integrated capital market across the EU that allows the free flow of capital, and the diversification of funding sources for businesses will enhance investment opportunities. This will be to the benefit of European financial services firms, many of whom are among the biggest advocates of the CMU project, and especially households and companies, who will see improved access to finance and investment opportunities.

The effort to build a large and liquid capital market should be partly at the EU level and focus more on tackling those deep-rooted barriers to cross-border activity e.g. related to insolvency law, taxation, supervision etc. However, there will also be a significant role for Member States to implement reforms at national level, in particular by taking measures outside EU-level competence, such as pension reforms, tax incentives etc. This need for this combined effort is reflected in the European Council Conclusions of earlier this year, as well as the Eurogroup statement.

A successful CMU will necessitate action well beyond the financial-services field. It will require a strong and stable EU economy and will leverage on a vibrant single market for goods and services. This implies that, in order to attract more capital market financing to the EU economy, policymakers must aim to lower economic risks and increase economic returns more generally. At the same time, CMU can contribute to economic growth by enabling funds to flow most efficiently from savers to borrowers. In efficient markets, capital will flow to projects and economic undertakings which offer the best perceived return for a given level of risk.

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In building CMU, there may be certain trade-offs triggered by considerations of open strategic autonomy reflecting a need to avoid overdependence on third country providers for key financial services. Open strategic autonomy is about improving the fundamentals for financial service providers in the EU to promote their competitiveness, and to reduce, where appropriate, systemic dependencies on third country operators. Global capital markets have a high degree of interconnectedness: more market participants mean greater liquidity, more competition, and more innovation. The idea is to make sure that the EU financial system interacts with other financial systems on terms that are sustainable and robust, also in times of crisis. These factors are of particular concern given the current challenging economic and geopolitical environment.

Over the longer term, CMU can unlock substantial economic gains for the EU economy by providing firms with access to a broader pool of capital, reducing the cost of capital, enhancing financial stability, modernizing financial infrastructure, and increasing competitiveness. Achieving CMU is also essential for putting pension systems on a more sustainable path and for achieving the green and digital transitions. The benefits of CMU will contribute to stronger economic growth, job creation, and greater economic integration within the EU, ultimately fostering a more resilient and dynamic European economy.

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A competitive Europe needs competitive financial actors

Competitiveness is a key priority for the next European Commission. It requires massive investments to upgrade the long-term economic potential of our economies, as well as its resilience and sustainability[1].

Europe being an open economy, we welcome investments from the rest of the world and count on them to contribute to funding our own transition and growth.

But we also need to keep strategic autonomy in this matter his means we need competitive European financial players able to withstand and overcome international competition in our domestic markets. Otherwise, there will be no alternative to becoming dependent on third-country groups providing key financing and services to Europe.

The problem is that European financial actors are currently losing ground on the global stage, and even in their own market, in most of the relevant segments.

In asset management, over ten years (from 2013 to 2023), the market share of American firms has risen from 30% to more than 42% among the top 30 players, whereas the market share of European players in the United States has stagnated at 2%[2]. On a global scale, the market share of European asset managers among the top 20 global players has fallen from 48% in 2008 to 20% in 2022.

European corporate and investment banks (CIBs) have seen their market shares steadily eroded over time under the effect of competition from their US counterparts. Between 2012 and 2022, the share of CIB income accounted for by US banks increased from 53% to 64% globally and from 39% to 51% in the EMEA region Consequently, in 2022, only three of the ten largest CIBs in the EMEA region were European.

A similar trend can be seen in the trading platforms segment, with increasing competition from non-continental players focusing on the secondary market and 'blue chips'. For instance, the American firm Cboe Europe had a market share of 24% in the volumes of European equities traded on trading platforms in February 2024, equivalent to the volumes traded on Euronext's primary markets.

Moreover, American brokers have also taken an increasingly dominant role in transactions at the expense of European banks and local brokers. This shift can weaken the ecosystem that benefitted small and mid-cap companies, as global players focus on larger capitalizations.

Such a state of play is of concern, but Europe holds all the cards to reverse that trend.

In fact, the current domination of American financial players can be attributed to multiple factors. Among them, banks' business models, deep capital markets and securitisation opportunities, the regulatory environment are critical. In particular, US CIBs owe a large part of their success to a deep, integrated and more profitable domestic market with a stronger focus on corporate and investment banking. On average, between 2020 and 2022 and on a like-for-like volume basis, commissions on mergers, acquisitions, and equity and bond issuances were between 1.3 and 1.7 higher in the United States than in the EMEA region.

On the contrary, the lower profitability of European banks is an illustration of the more fragmented and narrow European domestic market, where it is more difficult to build large-volume at-scale profitable operations, as well as a factor that weighs on the ability of EU banks to generate and attract sufficient capital to grow market share. As a result, in 2023, the average return on equity (RoE) of European banks was 7.6%, compared with 9.9% for American ones[3].

Because these are structural differences, they call for decisive and bold transformative action.

That is why we need an urgent relaunch of the Capital Markets Union to further integrate our domestic markets. Several proposals on the table will benefit the competitiveness of European financial actors.

First, the European securitisation market needs to be revitalised as soon and as strongly as possible. Here we need changes in the regulatory and prudential treatment of securitization as well as exploring the option of a common issuance platform. This will offer more possibilities to all financial actors and in particular give banks more ways to manage their assets.

We also need a more centralized supervision system for financial market actors to reduce fragmentation and to foster bigger pan European actors, able to better sustain international competition.

At some point, we will have to find a way to overcome the home-host issue in banking supervision so that our European actors can truly leverage the internal market to its full potential. If this means we need to further share the risks among our national systems, we are ready to do it. This will be the crucial nexus for the next legislature on banking regulation.

More generally, incorporating the impact on the competitiveness of European financial actors should now be a reflex when we draft and assess new regulations, at every level of text and for each public body involved.

To sum up, Europe's financial sector should be seen as a strategic asset which can help to improve significantly the competitiveness of our continent. Delivering its full potential will require bold action. Such vision can only succeed if it is embraced by all our policymakers, and factored in all their decisions and future pieces of legislation or regulation.

1. *Europe's moment: Repair and Prepare for the Next Generation, European Commission, 2020*
2. *Broadridge, November / December 2023*
3. *Developing European Capital Markets to Finance the Future, April 2024*

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Strong European banks and financial markets are at the heart of Europe's future

Over the last ten years, the EU has accumulated 15 full points of growth lag versus the US and US big banks have increased their CIB market share in Europe to over 50%. Over the same period, average CET1 of the banks supervised by the ECB/SSM has increased from 12,5% to 15,7% while the corresponding figure in the US remained stable around 12,5%.

Who could reasonably think that there is no link between those facts ? Beyond higher CET1 requirements EU banks suffer from other differences in regulation (e.g. MREL vs TLAC rules). Also, different rules in the US have fostered a securitization market that is now more than 10 times the size of Europe's, thereby giving US banks much more capacity to provide financing to the economy and feed the growth of US capital markets. These reasons and the existing obstacles to integration in the financial sector, as highlighted in the recent Letta report, contribute to Europe's slower growth and declining strategic autonomy. Indeed the Letta report stresses that the neglected EU financial sector must be brought back to the fore.

The previous EU mandate has yielded sweeping new legislations, which now will have to be implemented, leading to a very significant increase in capital expenditures. But where is the financing of the EU economy going to come from as public funds are scarce and will remain so in the foreseeable future? What is thus important to have in mind to move decisively forward?

Enable European banks: Until now, banking related European policies have unfortunately been mainly grounded on "demand-driven" approaches that are not conducive to growth. A real game-changer therefore would be for the EU to at last adopt a "supply-driven" policy posture to support the competitiveness of its financial sector. This would deliver a broader financial services market and result in greater access to finance and in a more comprehensive offer of financial products and services for EU companies and consumers.

Given the already high level of capital reached by EU banks, the EU must now take a more pragmatic stance as regards any further capital requirements; this is the necessary path to release the financing potential of banks, allow them to be more active on financial market and bring the much-needed fuel to the economy. The ECB's mantra to justify ever-higher prudential requirements is that "the more capital banks have, the more they will lend". But the fact is that a bank will only lend more when it has more ***available*** capital to do so. Faced with prudential requirements that are too high with prospects of them becoming even higher in the future, it will just lend less. Higher capital **requirements** cannot lead to more lending.

The neglected EU financial sector must be brought back to the fore.

Get CMU done: After a decade of sluggish progress, the further development and completion of the Capital Markets Union has become an absolute priority. The Letta and Noyer reports have identified important recommendations that EU policymakers need to consider carefully. Revitalizing the securitization market is one of them: it would allow European banks to accelerate the rotation of their banking books and share risk with investors, thereby boosting their capacity to lend more to the economy and contributing in parallel to more dynamic capital markets. It is an effective tool that Europe cannot afford to not use, all the more as it is conducive to increased financial stability.

Another observation is that CMU cannot be reduced to the idea of a "single supervision" as a necessary and sufficient condition. What is there to supervise, if there is only a fragmented and shallow market that does not function at European level?

Make optimal use of the ECB's mandate: under the ECB's secondary objective, the ECB is obliged to support the general economic policies in the Union with a view to contributing to the Union's objectives. Let's in particular recall the new European Competitiveness Deal, one of the goals shared by the Council in April 2024. The ECB cannot advocate its primary objective of price stability and refrain to play its role in the proper articulation of the financing of the economy. Supporting a competitive and strategically autonomous economy is indeed within the ECB's mandate. The ECB has demonstrated its capacity to articulate secondary objectives with its primary objective, for example in its recent climate related initiatives in pursuit of the Union's objective of addressing Climate change; likewise, a competitive European economy supported and funded by a dynamic European financial sector should be at the heart of its policy.

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MEGA... "Make European Equity Great Again"

In recent months, several initiatives have emerged that will serve to strengthen the integration of European capital markets. The Dutch banking and market supervisors, former Italian Prime Minister Enrico Letta, and former Governor of the Bank of France Christian Noyer have put forward concrete proposals to better drive European growth, and the European Council has embraced this ambition.

The Capital Markets Union, now renamed the "Union of Savings and Investments," is no longer a political orphan. Rather, it will be one of the pillars of the next European cycle, which has started with the European elections on 9 June and the appointment of a new European Commission.

A consensus is finally emerging on the need to resolve a European paradox. European household savings amount to €35,500 billion, driven by one of the world's highest savings rates at 13.3%. However, Europe exports much of these savings by purchasing foreign debt securities and relying on foreign resources to finance the equity of its economy. We therefore need to rethink completely the way in which savings and investments in Europe are connected.

Seven pillars are emerging to build the Union of Savings and Investments in Europe:

1. Consolidate access to capital markets for mid-sized companies and tech firms;
2. Integrate clearing and settlement infrastructures;
3. Revive securitisation by supporting it with a genuine European platform;
4. Implement a set of identical rules for capital markets across Europe;
5. Create an effective single supervisory framework for major capital market players operating in multiple member states;
6. Transform the market liquidity framework to direct a much larger portion of European savings into the shares of listed European companies;
7. Create a real global competitiveness test to allow the consolidation of European markets, in order to create global leaders in the capital markets sector in Europe.

To achieve these transformations, we need powerful market infrastructures capable of scaling up. In under 25 years, Euronext has become a central element of the Capital Markets Union in Europe. Today, Euronext is ready to contribute actively to the new phase of capital market unification, by bringing its expertise in two areas.

First, to continue reducing the fragmentation of post-trade activities, by deepening the initiatives we have already implemented at Euronext, so that the unique European liquidity pool is supported by a simplified, streamlined, and fully integrated post-trade structure.

European savings must finance European growth!

Second, in creating a single European access point for mid-sized companies and tech firms, in partnership with other exchanges that wish to engage in this project and with clear support from the institutions and market participants. This will provide companies with an integrated and efficient financing mechanism across the continent.

If we mobilise collectively, I am confident that we will be able to catch up with the United States in funding innovation. But two essential changes do not depend on European decisions and must be taken immediately by member States.

First, we must eliminate all mechanisms that artificially divert long-term savings from equity investments to debt instruments. This means removing fiscal distortions for households and revisiting prudential ratios applicable to institutional investors. Increasing the share of European savings invested in equities will not only yield higher long-term returns, but will also support competitiveness, economic development and employment in Europe. More investors in European equities are needed to reduce the liquidity gap with the United States. This will not happen as long as European households and insurance companies are incentivised to buy debt rather than equity.

Second, we must quickly enable the emergence of funded pension schemes. We cannot lament the gap between the United States and Europe in the proportion of individual investors in equity markets – 30% and 3% respectively – without considering that most households in the United States must invest in equities to secure their retirement, while most European households must rely on the hope that their fellow citizens will continue to pay taxes and social contributions to fund their retirement.

A strong political leadership is essential to establish a Union of Savings and Investments in Europe. This union will heavily depend on national decisions taken by member States to direct savings towards listed companies, by creating the most suitable conditions for households and institutional investors. Such a combination of European level efforts to integrate capital markets in Europe and member States initiatives at the national level will make European equity great again.