Capital Markets Union: future steps

1. Progress made with the CMU initiative

1.1. Progress of the regulatory framework but limited impacts in the market

The panellists acknowledged the significant work that has been done on the capital markets regulatory framework since the launch of the CMU initiative in 2015, but several speakers highlighted the lack of progress in terms of effective market growth and competitiveness of EU capital markets.

A policy-maker stated that the overall direction of the CMU is positive. Much has been done since the launch of the CMU 10 years ago with the adoption of three comprehensive action plans. Several promising measures have been passed, notably in the 2020 action plan, including the MiFIR review and the Listing Act.

An official agreed that much has been done on the regulatory front, leading to an improvement of the single rulebook. There is however a sense of frustration with CMU, as little progress has been made in terms of effective market development and integration. Stock market capitalisation in the EU still represents 62% of GDP compared with over 150% in the US. Financial markets remain fragmented along national lines. This is the case in particular in the post-trading space, where a great number of central securities depositories (CSDs) subsist and where processes are not yet sufficiently efficient. In addition, supervision is not yet sufficiently unified. It must be recognised however that preparing and implementing regulations takes time with the current EU legislative process, so the effects of CMU cannot be short term.

A regulator stressed that several key initiatives, such as consolidated tape and the European Single Access Point (ESAP), still need to be fully implemented to realise their benefits. In addition, regulatory measures alone will not be sufficient for achieving the broader objectives of significantly developing and integrating European capital markets.

An industry representative agreed that a great deal has been achieved in terms of regulation and that a lot of political effort has been made, but that this did not result in the desired effects on the markets. All key proxies continue to illustrate this. The EU accounts for only about 10% of global IPOs and much less if you exclude Sweden, the EU's IPO machine. Market capitalisation in the EU is around 50% of GDP, compared with around 190% in the US. And a growing number of companies no longer see the EU as an attractive place to do business, with many moving abroad or not coming to the EU at all. In addition, there is significant fragmentation of trading venues across the EU and even within member states, with more than 500 venues active in Europe.

There are also challenges on the demand side. According to recent data, EU citizens demonstrate a strong preference for investing in international securities, with only about 25% of equity investments allocated to EU ISINs. The rest of the flow goes abroad. In contrast, in the US and Asia around 80% of investors invest within their own jurisdictions. There is an urgent need to act given the negative spiral created between weak growth, fiscal and monetary policy.

A second industry representative stated that there are three fundamental points to consider in assessing the effective progress made with CMU: whether dependency on bank debt has been reduced, whether supply of public and private equity has increased, and whether the supply of equity has been better distributed across Europe.

Efforts made on CMU have not delivered a satisfactory result so far on the supply or demand side. While there have been improvements in some countries, such as Sweden or France, there is no benefit at the aggregate EU level. In addition, the progress observed in these countries is not due to the CMU but rather to domestic strategies or the role of legacy institutions, such as Bpi in France. Public markets have declined and progress in private markets is concentrated in a limited number of markets. There is a lack of financial capacity and money going into European markets and also a lack of operational capacity. There is a shortage of adequate vehicles through which pension funds and retail investors can invest, as well as a general absence of a risk culture, both from investors and companies. A great deal of effort has been put into regulation, particularly on the supply side, but action must be more focused on the increase of equity financing of enterprises going forward.

A third industry representative agreed that there has been real progress in the capital market regulatory framework, although the legislative process has been too slow. The reviews of the Alternative Investment Fund Managers Directive (AIFMD) and European Long Term Investment Funds (ELTIF) frameworks were positive, as well as the measures adopted in the context of the MiFIR review, such as the implementation of consolidated tapes, which should contribute to increase market transparency and liquidity. This will be beneficial for the ETF market in particular More efficiency must be gained in the broader ecosystem however, with the development of wider and deeper liquidity pools. Primary and secondary markets in Europe are still much smaller, in comparison to the US, when considering the market capitalisation of long-term financial assets compared to GDP.

There is a cultural element in the lack of development of European capital markets, but culture can change with market innovations, especially with changes in distribution, the industry speaker suggested. Rapidly growing neo brokers and digital wealth platforms in Germany for example have attracted many first-time and younger investors. Sweden and Denmark also offer positive examples in Europe where capital has been put to more productive use.

A fourth industry representative emphasised that progress has been made in the consolidation of the post-trading market over the last few years, with three major groups now representing roughly 90% of the volume. However, the advantages of this consolidation have not yet fully materialised due to persistent legal and fiscal barriers and differing market practices. Further integration is achievable, but it requires time and appropriate regulatory conditions. The US market went through consolidation efforts in a more harmonised environment that eventually led to a single CSD. Europe is on a similar journey that needs pursuing. The European financial market infrastructure has always been robust, helping to maintain safe and competitive capital markets.

1.2. A new political momentum around CMU

The panellists welcomed the current political momentum around CMU as a new political cycle is about to begin in Europe.

An official considered that the current political momentum is cause for optimism on CMU. The Draghi, Letta and Noyer reports on CMU, and contributions from the ECB and ESMA, make a clear description of the situation of capital markets in Europe and set out key elements on which progress can be made. These opportunities must now be seized to build a clear agenda for further action.

An official agreed that there is reason to be positive on the future potential of CMU. The Draghi report in particular gives a clear indication of what can be done. The current CMU action plans also provide a strong basis on which further actions can be built, with measures such as ESAP and the Listing Act.

An industry representative also noted the positive political momentum around CMU following the publication of the Eurogroup statement and the Draghi and Letta reports. It is now time to create a concrete action plan based on the proposals made to move towards a real savings and investment union.

An industry representative observed that, beyond the willingness and political momentum demonstrated in the reports recently published on CMU, there must also be a greater sense of urgency.

2. Approach for the next steps of CMU

2.1. Focusing more on tangible action than regulation

An industry representative pointed out the excessive focus on regulation of the CMU initiative so far. More tangible action is needed now, driven by investor and issuer demand. The key challenge is how to generate more public and private market equity and distribute it effectively across Europe.

Europe however needs a different approach from the US style venture capital model, which is largely focused on leveraging, controlling and selling companies. In Europe the focus should rather be on long-term patient capital, minority equity stakes, and forming genuine partnerships with venture capital institutions. It is unrealistic to expect a surge in retail investment in SMEs, and pension funds lack the vehicles to invest in smaller European companies. Banks should therefore play a central role in filling this gap. The UK's Business Growth Fund (BGF) model which has been replicated in Canada, Australia, and Ireland, is a good example of how this can be achieved. Banks, which hold the savings, should be encouraged to collectively invest these funds in companies, in a way that creates scale, efficiency, and impact. Such an approach is preferable to further regulatory changes, as meaningful CMU progress depends on the financial industry mobilising to meet the challenges rather than on additional regulatory measures.

Another industry representative suggested that time must be given for the initiatives adopted in the context of the CMU action plans to settle and deliver their full effect before considering any further regulation. A more investor centric approach is needed in the next steps of the project to bring savers on board and encourage them to invest in the capital markets. Tax measures to incentivise retail investment are important to consider for example. The industry also has a role to play in achieving the objectives of CMU. Securitisation can help banks to play a more active role in the funding of firms by freeing up their balance sheets. Asset managers have an equally important role to play in attracting investors to the capital market and mobilise their savings in a more effective way, building on well-regulated, attractive vehicles, such as UCITS and the recently reviewed ELTIFs. Pension funds and a reshaped PEPP could also contribute to developing capital markets.

A regulator emphasised that regulatory reform alone will not create a robust capital market. The supply and demand for capital must improve. This requires a more conducive ecosystem for listed companies and a greater emphasis on incentivising investors and boosting capital flows.

A policy-maker agreed that, while regulation is a key part of the solution for further developing and integrating capital markets in Europe, it cannot fix everything. Markets must also be driven by the industry as well as evolutions of society, such as enhancing financial literacy.

2.2. Completing European initiatives with actions at member state level

A regulator stated there should be combined efforts at European and member state level. The Commission should work on common policy issues likely to drive CMU forward and member states should step up their efforts to develop their national markets in a way that is consistent with the CMU objectives.

A policy-maker stressed that while member states can take measures for the development of their own capital markets, it is necessary to identify the areas where convergence can be beneficial at the European level. In addition, a European approach is needed for cross-border issues. An industry speaker agreed that the measures taken by member states to step up their capital markets should be consistent with the actions taken at European level.

Answering a question from the Chair about the possibility of using enhanced cooperation mechanisms among a group of member states for measures where EU-level agreement is not possible, an official stated that such an approach would not be relevant in this case. The process is

too long, taking up to three years and is quite complex. For promoting a new savings product for example, it would be better to build a coalition of the willing from the start with the member states that would be interested and agree on a set of common key features. Involving the private sector is also essential, since, ultimately, the product will need to be widely adopted and promoted by the private sector to create a new pool of liquidity for the new asset class. The experience with the PEPP initiative, which did not deliver what was expected, should not be reproduced. Although there was a properly crafted political compromise at EU level, it did not work in real life.

An official suggested that the political feasibility of policy proposals should also be better taken into account when proposing EU reforms.

2.3. Streamlining regulation and improving the legislative process

An official considered that European capital markets are suffering from overregulation. A key priority is to reduce the regulatory burden where possible. The starting point should be to identify the complexities created by existing rules and the impacts this may have in terms of disincentives to investment, diversion of resources and hampering of innovation. The relevance of financial frameworks in an increasingly digital environment also needs considering.

An industry representative suggested that the approach to regulation must be reformed to enhance the competitiveness of EU capital markets. Level 1 texts must be streamlined, and supervisors must have more freedom to adjust Level 2 and 3 standards. This would require a review of the Meroni doctrine as well as measures to enhance the agility of rule-making in the EU, in line with the approaches that exist in the US and UK where market competitiveness is part of the authorities' mandates..

A regulator agreed that there is a need to move towards a more efficient regulatory approach in financial markets in Europe that can adapt more quickly to market changes. The Level 1 framework should remain at a high level, rather than including an excessive amount of detailed rules.

The Chair echoed the comments made on the current legislative process. Co-decision is too exhaustive and slow. Many unresolved issues are passed to the European supervisory authorities, creating a system that becomes overloaded with mandates and tasks. This results in a clogged, sluggish system. The Lamfalussy process, originally designed to work as a set of principles to ensure regulatory efficiency, is no longer being applied effectively in some cases.

2.4. Work on the labelling of the CMU and the underlying economic rationale

An official noted that it is not always easy to explain the purpose and need for CMU to national politicians. This contributes to creating a gap between European policy-makers and member states on CMU.

Another official agreed that the narrative around the project is important. The way CMU has been presented is perhaps too technical and insufficiently aspirational. The proposal to change the name of CMU to a savings and investment union makes sense, but what is needed now is primarily taking action in the key areas highlighted by the recent reports on CMU. Answering a question from the Chair about the need to demonstrate more clearly the economic rationale for CMU, the official suggested that the focus should now be on achieving tangible and convincing deliverables rather than spending time on demonstrating the economic rationale of CMU, which is quite a complex task.

An industry representative noted that the competitiveness of the European economy is a key driver of CMU. If Europe is not an attractive investment destination, investors will not invest their capital in Europe. The two are closely connected. There cannot be strong capital markets without a competitive economy and an economy cannot be competitive without vibrant capital markets

Another industry representative observed that CMU and mobilising private capital are particularly important considering Europe's very challenging economic position, with recession looming in Germany and Eurozone growth at only 25-30% of the rate of the US economy. Fiscal and monetary policy instruments are no longer as effective as they used to be and large number of member states have unsustainable public finances at present.

3. Key areas of focus for future CMU work

3.1. Policy priorities for the next steps of CMU

A regulator emphasised that there are three perspectives to consider for CMU going forward. First are the sources of capital that firms and the economy need; secondly, there are issues on the demand side, where household savings are not being used productively or delivering sufficient benefits for investors. Thirdly, there needs to be greater regulatory and supervisory harmony across the EU to break down legal barriers and tackle fragmentation. European rules must also be applied and supervised in a common way.

A policy-maker stated that further work is needed in the next political cycle to address the structural challenges that prevent deep and liquid capital markets in the EU. There are persistent legal divergencies mostly stemming from areas that are beyond the remit of financial services, such as company, securities and insolvency laws. How to further integrate financial market infrastructures without necessarily fully harmonising these laws and rules needs to be further assessed, as well as how to improve supervisory convergence.

On the investment side of the CMU, there are also a number of issues to be considered, such as securitisation, on which a consultation will be conducted; how to develop venture capital in Europe; and how to make better use of retail savings, beyond the measures proposed in the Retail Investment Strategy (RIS). Tax incentives are an important aspect of encouraging retail investment, which is the responsibility of Member States. Opportunities for convergence in this area need to be explored. Improving

retail investment products and accounts should also be further examined, as should the development of occupational and personal pensions.

An official observed that the way the CMU project is structured is important. As proposed in the Noyer report on CMU from April 2024[1], it seems appropriate to focus on a limited number of more visible proposals that may be easier for ministers to endorse and monitor than the comprehensive approach taken so far. These proposals include creating an EU-level investment product label, promoting integrated supervision, reviving the securitisation market in Europe and working on post-trade integration. While there are other issues to be addressed, such as the fragmentation of insolvency law, it is important to focus on a limited number of initiatives.

Securitisation is an area where it should be possible to move forward quickly because all the elements are on the table, the official pointed out. A consultation needs to be launched very soon to assess the prudential and regulatory aspects and also concrete solutions to promote securitisation, such as the type of platform that is needed drawing on the US experience.

An industry representative observed that, while securitisation is useful for increasing the financing capacity of the banking sector, it remains focused on debt rather than equity.

A second industry representative highlighted two key priorities for the CMU's future steps. The first is to improve the supply of capital to the economy. This is not only a question of attracting capital flows from outside Europe but is also about mobilising savings in bank accounts for more productive use, by providing appropriate investment solutions for retail savers and developing pre-funded private pensions, building on existing best practices. IFIs operating in Europe, such as the EIB and the EIF, should also be strengthened and better used to finance scale-ups and support IPOs. Second, the depth and liquidity of European capital markets must be increased to make them more attractive to investors and issuers. This requires an improvement in market structure. The European trading space needs to be further rationalised, with additional rules on dark trading and a simplification of MiFID and MiFIR exemptions that are too complex to apply.

A third industry representative considered that the recent reports on CMU provide appropriate analysis and guidance on Europe's challenges and priorities. The focus should be on creating demand and supply for capital, turning savings into investments and attracting and retaining more companies in Europe.

Efforts to further integrate the EU post-trading space also need to be pursued. Some consolidation has taken place at the post-trading infrastructure level, but it is important to further reduce costs through additional synergies. Efforts by infrastructures covering multiple markets in Europe to build common IT platforms and operations to achieve synergies need to be continued. It is also important to take advantage of available opportunities for integration at the European level. There are interesting examples, such as Ireland's decision not to have a national CSD and to enable CSD services to be provided by an entity in another Member State. Another example is the Eurobond market. Created some 60 years ago, it is the third largest fixed income market in the world at around €13 trillion and attracts many non-European issuers. It is also very important to maintain a level playing field in the European post-trading market, supporting fair competition between providers.

A fourth industry representative added that providing fund depositaries with a European passport is another integration opportunity worth considering. This could facilitate a further integration of asset custody activities, which are fundamental to the functioning of the asset management market. The investor perspective should also be at the forefront of the CMU's future steps, in particular ensuring that investors have access to the right products and that these products are adequately distributed.

3.2. The prospects of a more unified supervision

An official suggested that progress should be made towards more integrated supervision. There should not be a complete shift from national supervision to fully integrated supervision, but there needs to be a sense of momentum with concrete steps towards more integration.

A regulator considered that there is value in coordinating supervision at European level where it makes sense and where there are clear benefits. This is the case for some cross-border activities, but supervision of most national and smaller players at the European level does not seem necessary.

An official noted that particular caution must be exercised when considering the extension of unified supervision. Financial market supervision must be carried out at the appropriate level. While some activities can be supervised at EU level, it is important to maintain the supervision of domestic products and services at the member state level.

The Chair agreed that caution is needed when considering changes at the supervisory level but observed that some redistribution of responsibilities would be appropriate. For instance, systemic or cross-border activities could be more effectively managed at the EU level, while domestic players should remain supervised at national level.

Conclusion

The Chair summarised that the start of the new political cycle is a crucial moment for CMU. Much has been done since the launch of the initiative, and many new ideas have been set out. There is now a strong political momentum around CMU and a new sense of urgency. However, without a high-level political agreement at Council, Commission and Parliament levels on the direction of travel and the timeframe of the CMU, there is a risk of slipping back into a complex process that does not deliver on the key regulatory issues.

1. Proposals for a Savings and Investments Union – Developing European capital markets to finance the future – Report drafted by a committee of experts chaired by Christian Noyer April 2024.