# NEW CMU ACTION PLAN

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## Towards CMU: how to incorporate safely a more retail-oriented market

CMU is an essential component to achieve deeper markets, better investment choices and healthier financing by companies. It acquires even more relevance in pandemic times, as we have seen how important for companies is to have enough equity and for investors to have diversified portfolios across different Member States. But we have also seen, thanks to Brexit, how relevant is to have diversification on financial centers. A polycentric financial marketplace is not only more competitive but also more robust. This is compatible with a polycentric financial supervision, bound together by tighter coordination mechanisms and a stronger ESMA.

One aspect that merits attention is the coincidence of new entrants into the markets in the SME spectrum and the increased participation of the retail investors. While these two trends, taken individually, are worth supporting, we should be extremely careful when combining them, especially if at the same time we promote a lowering of disclosure requirements by issuers. Those three ingredients could be a dangerous combination for the following reasons. Firstly, the retail end of the spectrum may lack the training and experience needed to assess SMEs. Secondly, research coverage is very thin for the SME part of the listed companies. Thirdly, SMEs are frequently subject to higher volatility and default rates, making them the riskiest part (also the most promising sometimes) of the investment spectrum. The ingredients for mis-selling, losses and possibly a withdrawal of confidence in equity markets from retail investors would be served if we stimulated both processes at the same time.

**Collective investment key for diversification and risk reduction in a retail-oriented CMU.**

I genuinely think that the only intelligent way of promoting at the same time the new flow of SMEs and an increased retailisation of the buy side is to promote retail investors accessing this new market through collective investment. Collective investment schemes run by professional managers provides both diversification, which is key when we talk about SMEs, and research capabilities that are absent in that niche, hence reducing risks and increasing return for retail investors. Actually, these types of vehicles could even be incentivised from a policy perspective vis-a-vis direct investment in single SME stocks.

Collective investment schemes could also professionalise SMEs through their role of stewardship, which is becoming more popular in the area of sustainable finance. Nevertheless, the role of Asset managers in SMEs markets should be closely monitored by supervisors to avoid any market abuse situation and keep confidence in primary and secondary markets.

Capital markets have withstood the COVID crisis remarkably well and the extreme volatility we observed in March-April 2020. Although IPOs were quite scarce in 2020, we have seen a clear surge in 2021. But even during the direst times, companies that were already listed and that required financing found relevant demand at fair prices in EU equity and fixed income markets. Some Spanish companies, for instance, led the biggest secondary equity offerings in 2020 and being already listed made a real difference for them compared to what would have been the case as a non-listed company. The depth shown by EU capital markets was truly remarkable in that sense.

It is obvious that we need to bring more companies to the listed world, from all sides of the spectrum: large and small, traditional and innovative. To do that, lowering costs and reducing the time required to access the market is appropriate, but when doing so we should not lower investor protection. The key for strong and stable capital markets is long-term trust from investors as well as the development, improvement and refinement of an appropriate financial education that allows, to all investors, a better understanding of risk in the investment decision making.


# JOÃO NUNO MENDES

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## Capital Markets Union: supporting recovery and the green and digital transitions

The *motto* of the Portuguese Presidency - "This is the time to deliver: a fair, green and digital recovery" - encapsulates the unique challenges at this juncture in time: i) the absolute priority to relaunch the economy and the recovery; ii) the sense of urgency, at EU-level, of the implementation of the Recovery and Resilience Facility (and the approval of national recovery and resilience plans) and iii) the unique opportunity to ensure a green and digital transition.

The response to the Covid-19 pandemic saw an unprecedented scale of public support to businesses and employment, a combination of liquidity measures and working capital support that has helped European businesses weather the crisis.

Financial stability and resilience must be monitored closely. The phasing out of public loan guarantee schemes and moratoria on loan obligations must be timed carefully, mitigating the short-term risks for the economy and the banking sector.

Financial institutions played a crucial role, and although the European financial sector has entered the crisis better prepared, the risk of contagion from the real economy to the financial system, namely through non-performing loans, must be acknowledged and addressed.

Financing the recovery is a pivotal challenge going forward and a *"true Capital Markets Union is key to an efficient and robust European financial architecture"*[1]. Moreover, the CMU is also key for a stronger international role of the euro.

Capital markets have an increasing role to play in accelerating the recovery and the green and digital transformation, complementing bank financing, and mobilizing additional capital for investment and recapitalisation of EU corporates.

The Portuguese Presidency welcomes the European Commission´s new Capital Markets Union (CMU) Action Plan and the Council Conclusions adopted in December, which we consider to be very comprehensive. In this regard, the awaited KPI on CMU will be important to measure progress in implementation.

**Capital markets have a growing role to play in the recovery and green and digital transition, mobilizing additional funds to recapitalise EU firms.**

We have been supportive of advancing actions that improve market access conditions for smaller firms, supporting them in recovering from the aftermath of the Covid-19 crisis and diversifying their funding sources. In this regard, we would highlight the importance of strengthening the role of securitisation in providing additional financing to the real economy.

We also look forward to the Commission´s proposal on the Single Access Point which, in our view, has great potential in improving accessibility of relevant information on European companies.

The progress in the implementation of the CMU must also be seen in conjunction with the work in other areas, such as the implementation of the Next Generation EU Recovery Fund, the Banking Union, the Digital Finance Strategy and Sustainable Finance.

For example, the Portuguese Presidency is committed to making progress on the Regulation of Markets in Crypto-assets (MiCA) and the comprehensive framework on digital operational resilience for EU financial entities (DORA), which also contribute to the CMU. The implementation of the Capital Requirements Regulation/ Directives review, allowing to phase-in the reforms in such a way that the critical role of banks in supporting the recovery is not hampered and, also, encouraging more long term and equity financing to SMEs.

The Commission's proposal on the EU Green Bond Standard should contribute to promote the development of the market and consolidate the role of the EU in green financing. We see great opportunity to expand the existing capital markets products toolkit to better suit the recapitalisation needs of European corporates which have seen their equity base eroded due to the COVID-crisis.

We have mentioned the role of securitization, but we also see with great promise the progress in the development of hybrid solutions in some EU countries and see the potential to share knowledge and best practices in this regard.

1. Euro Summit meeting (11 December 2020) – Statement

LAURA
VAN GEEST

Chair of the Board,
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## Working towards high quality supervisory outcomes across the EU

The AFM fully supports the objectives of the CMU and encourages the EC in its efforts to further strengthen the CMU by striving for liquid, transparent and accessible EU capital markets. A healthy financial system breathes with two lungs: 1. a robust banking system, and 2. resilient and diversified capital markets. It is key for the EU to keep working on stronger integrated capital markets in order to avoid over-reliance on the banking system. The AFM encourages the regulatory efforts taken so far. However, Europe's financial system is still very much dependent on banks and the strong home-bias in bond and equity markets indicate that markets are not yet fully integrated.

Overall, we believe that the Commission is focusing on the right topics in its current CMU action plan. We especially endorse proposals that lead to central solutions for EU wide problems. Such as proposals concerning a European Single Access Point or a consolidated tape.

Furthermore, there is still a significant need as well as high potential for increased participation of retail investors in EU capital markets. EU investors' overall participation in capital markets is relatively low. However, the demographic changes (ageing population) across the Union require larger retail participation. At the same time, retail participation increases the opportunities for SME funding. The AFM believes that efforts should be made to further increase the level of investor protection. In order to enable the retail investor to enter into cross-border transactions, they should be able to expect similar high quality supervisory outcomes across the EU.

Larger retail participation must go hand in hand with improved investor protection. We hope that the upcoming Retail Investment Strategy by the EC acknowledges this need and aspires to raise the bar for investor protection. As a market conduct supervisor, we will also look with a bit more caution to proposals that might even jeopardize investor protection, such as introducing a new category of qualified investors, or to proposals to soften for instance listing requirements for SMEs.

**For EU markets to function properly, the geometry of supervision should follow the geometry of the business.**

In order to effectively supervise cross-border retail financial services, we believe that specific attention must be paid to issues related to the current passporting regimes. The AFM encourages the EC to analyse both the positive and negative aspects of the current passporting system and the supervisory challenges thereof in order to look for solutions that will empower NCAs to effectively protect investors domestically. While being a cornerstone of the single market, the current system – with 'home' and 'host' responsibilities - imperils the effective protection of investors that are engaged in cross-border transactions.

We can also fully support any further work to strengthen supervisory convergence, or even further centralization of certain supervisory tasks. We believe that cross-border problems require cross-border solutions. Individual supervisors are not always able and in the position to effectively supervise individually. Therefore, for a well-integrated and functioning CMU it is key that ESMA and the national authorities further build on the work currently undertaken in their efforts to collectively address cross-border risks.

However, convergence also has its limitations, it will not make full use of the potential efficiency and effectiveness gains, nor does it eliminate the risk of regulatory arbitrage. The ultimate convergence is centralization of direct supervision. We believe there is a strong case to be made to centralize supervision on markets that are cross-border by nature, where the risks are cross-border related, rules are harmonized, and we see a risk of regulatory arbitrage. This would in our view logically lead to centralization of certain supervisory tasks at the wholesale side of the capital markets.

To sum up: For EU markets to function effectively, high quality supervisory outcomes are required. Regardless as to whether the supervised entity (firm/business) is primarly offering services on a local or cross-border basis. Supervision should therefore be organised accordingly.

For EU markets to function properly, the geometry of supervision should follow the geometry of the business.

THOMAS BOOK

Member of the Executive Board, Deutsche Börse Group

## The EU as a key player in financial markets – not the playing field

This year's Eurofi Forum in Lisbon comes at a historical moment for our financial markets. The EU is facing a critical juncture: we urgently need to finance our recovery plans from the Covid-19 crisis, as well as drive the green and digital transformation at full speed. The unprecedented pressure on public finances and bank balance sheets makes it indispensable to foster deep and thriving capital markets to finance these ambitions.

However, key metrics show that EU capital markets are still significantly less developed than in other leading jurisdictions. In 2020, looking at primary markets, there were 1,415 IPOs, of which 60% happened in the US and China. Only 7% took place in the EU. Similarly, if we look at the ratio of market capitalization to GDP, the US is at 148% while the EU lags behind at 53%.

The EU has sent a strong signal of unity with the EU Recovery Package. And the rapid implementation of the new CMU Action Plan is critical to support the EU's efforts going forward. However, the time has come to strategically make the EU a key player in the global financial arena by building synergies between existing areas of reform and taking leadership in new strategic growth areas.

This includes redefining our financial services landscape by linking the eurozone and CMU reforms to the strategic objectives of the international role of the euro initiative. To this end, we need a fit for purpose regulatory framework that supports our markets and strengthens the resilience and competitiveness of the EU's financial market infrastructures (FMIs). As Executive Vice-President Dombrovskis and Commissioner McGuinness put it: We need to "reinforce the EU infrastructure that underpins our financial system".

Against this background, the European Commission's strategy to promote the "openness, strength and resilience" of EU financial markets is a vital step in the right direction to complete the CMU agenda. It highlights the importance of EU FMIs, as well as key EU markets, to strengthen our financing capacity and stability.

**The time has come to strategically make the EU a key player in the global financial arena.**

In this sense, three aspects are paramount:

1. You cannot have a CMU, deal with the impact of Brexit and ensure a sustainable recovery from the COVID-19 crisis without functioning, deep and liquid secondary capital markets that allow for a robust price discovery process and efficient capital allocation. ESMA's recent market structure report reveals very high fragmentation (more than 250 venues; versus 60 in the US) and overall low levels of transparency since the introduction of MiFID II. More than 50% of the volume is still traded off regulated exchanges.[1] Paired with recent developments, such as the significant rise of payment for order flow schemes, it is therefore critical to simplify the EU equity market structures and effectively limit "dark trading" to increase transparency and general measurability for end-investors.
2. To support long-term and sustainable growth, it is essential to continue strengthening the EU's resilience and financial stability and reducing our overreliance on offshore markets. Achieving our "Euroclearing" objectives must be a priority, as well as securing the Euro Area's well-functioning and liquid exchange-traded derivatives (ETDs) market. The mandatory "open access" rules for ETDs run counter to these objectives, put financial stability at risk and should be revisited, also in light of the fact that no other jurisdiction is applying them. And we need to consistently and systematically build up euro-denominated markets to reduce the dependencies and reliance on third countries.
3. Finally, the EU should continue to take global leadership in new strategic growth areas such as sustainability. The EU can be the global leader in this sphere, set the standards, be competitive while having a role model function and defending our core values. Other jurisdictions start following us on this path, we can be bold and ambitious.

Let's embrace this broader perspective of openness, strength and resilience across the board – bring a balance into the relationship of the size of our real economy and our population with our financial industry – and make the EU and its capital markets global leaders that deliver in the societal interest to provide for a sustainable outlook for future generations!

1. ESMA, Annual Statistical Report on Securities Markets 2019, November 2020.

BERNARD SPALT

Chief Executive Officer,
Erste Group Bank AG

# Capital markets and the pandemic: the new CMU action plan in light of the post-Covid recovery

As we try to grasp the massive economic effects of the Covid-19 pandemic, we must realize that a crisis is not only a destructive force, but also a chance to reconstruct. Developing the EU's capital markets, and ensuring access to market financing, will be essential in this respect. We are convinced that better-capitalized companies and a vibrant capital market are two of the most essential ingredients to rebuild Europe's economy.

The second CMU action plan has its focus on three pillars:

1) support of green, digital, inclusive and resilient economic recovery by making financing more accessible to European companies;
2) make the EU a safer place for individuals to save and invest long-term;
3) to integrate national capital markets into a genuine single market.

With all of these angles Erste Group can highly associate and we do believe they cover key elements of the path to economic recovery. In our initial assessment we found that the CMU action plan covers four areas that are of strategic importance for the further integration and development of EU capital markets. These are measures:

- to incentivize retail investment (e.g. through adjustments of MiFID rules on advice);
- to promote equity investments (e.g. through reduced capital requirements);
- to foster financial literacy and,
- to improve protection of intra-EU investments.

Without a doubt, all of those measures are important as they will contribute to an overall strengthening of Europe's capital markets. While the CMU action plan is a comprehensive plan addressing both short-term and mid-term targets, we must realize that the economic pressure stemming from the pandemic is tremendous and that there is an obvious need to prioritize.

**Generating growth for Europe's post-Covid-19 economy depends on higher levels of equity, especially for our SMEs**

We consider measures to improve the equity base of SMEs particularly important – not without reason are they often referred to as the "backbone" of the EU economy. Almost 60 percent of the continent's GDP and 70 percent of the jobs depend on this sector. In smaller countries these ratios can be even higher. Most of the SMEs are not publicly listed and heavily rely on bank financing. Just as during past crises, slumping revenues during the pandemic have eaten into these companies' capital, limiting their ability to borrow and take risks, which ultimately hampers investment in new business areas such as green technology.

Having the post-COVID business environment in mind, we must think of possibilities to strengthen the equity base of SME. Such possibilities are partly reflected in the points mentioned above, but also in other areas of the action plan such as the idea of a European Single Access Point (ESAP), simplified access to public markets for SME, the review of European Long Term Investment Fund (ELTIF) regulation, the promotion of referrals for SME to market-based financing options as well as the review of the securitization framework.

Apart from these initiatives there is also a lot the private sector can do. Erste Group has for instance started an equity initiative for SMEs more than 10 years ago and we recently further increased our efforts in this area. From a practical point of view, creating a legal framework throughout the EU, which enables such initiatives even further and also strengthens retail investments is of key importance. Here we see a need on the EU level to spread best practices across member states.

The situation is even more pressing as the pandemic has triggered a large increase of private savings, which could partially be used by retail investors to contribute to and participate in the economic recovery within the EU.

Generating growth for Europe's post-Covid-19 economy depends on substantially stronger market financing and higher levels of equity, especially for our SMEs. The CMU action plan is an adequate tool to contribute to achieve this but needs to be followed by bold political decisions on all levels.

Ultimately, better capitalized SMEs and a more integrated capital market will help to advance what Europe really needs to become more crisis-proof: ambitious digitalization and sustainability agendas.

RIMANTAS ŠADŽIUS
Member, European Court of Auditors

## A way forward for EU capital markets – the auditors' view

As the Union's independent external auditor, the European Court of Auditors (ECA), not only assesses implementation of the EU budget, but also the performance of EU institutions and bodies in reaching their objectives. Among others, we evaluate actions of the European Commission, the European Supervisory Authorities, the European Central Bank as a banking supervisor and the Single Resolution Board. The ECA has been publishing reports on the EU's financial and economic governance since 2014. One of our recent reports deals with the Commission's work on the development of EU capital markets and building the Capital Markets Union (CMU).

In this report, titled "CMU – Slow start towards an ambitious goal", we concluded that the Commission has indeed pursued a number of legislative initiatives and other measures to implement its 2015 CMU action plan, yet no catalytic effect was observed. Many of the measures that the Commission was able to take within its remit only addressed narrow areas in the pursuit of the CMU objectives. So far, they did not lead to the highly anticipated structural shift from bank to more market funding for businesses in general, and SMEs in particular.

We observed that large discrepancies between Member States persist in the size of the SMEs' financing gap and the availability of funding sources. Access to capital markets remains expensive and burdensome, especially for SMEs. The so-called 'debt-equity bias' is a disincentive for the development and integration of capital markets. Other issues, such as a lack of harmonized insolvency proceedings and the general diversity of company law across the EU, are well known. The Commission's new 2020 action plan strives to address many of the issues identified.

Certain actions, such as simplification of listing rules for public markets, can contribute to more market funding and private risk sharing, if implemented well. A simplified system of providing relief from withholding tax, as recommended by the ECA, could also bring significant improvements. However, without political dedication in building a truly European capital market and further measures to tackle key cross-border barriers, it will be difficult to deliver added value for EU businesses and investors. Hence, support and joint decisions by Member States is required, which so far have proved to be problematic.

**Fostering efficient local capital markets will be key for building a genuine CMU.**

Fostering efficient local capital markets will be key for building a genuine CMU. Indeed, capital markets in Europe remain highly concentrated and strikingly heterogeneous among Member States. Thus, the first step would be to render local capital markets deeper, more liquid and better aligned with regional counterparts. This will require willingness, comprehension, substantive efforts and delivering real structural reforms.

To tackle the needs of Member States, in particular with less developed capital markets, action at both, national and EU-level, is required. We recommend to establish a comprehensive EU-wide strategy bringing together all relevant public sector actors, such as EU and Member State authorities as well as promotional banks, in order to identify and address the needs of local and regional capital markets and businesses seeking market financing.

We recommend that the Commission use more actively all available tools, such as technical support and country-specific recommendations, to incentivize and help build financial ecosystems across Europe, not relying solely on national initiatives or demand. The coordinated creation recently of the legal framework for covered bonds simultaneously in three Baltic States is one example.

Another necessary action to address key cross-border barriers to investment is the reinforcement of financial literacy specifically among SMEs, primarily start-ups that are looking for ways to fund their not always "bankable" ideas. Although this mainly falls under the remit of Member States, the Commission can still play a critical supporting role via existing European programmes and by promoting best practices.

The ECA will continue to report on the EU's progress towards a single market for capital. We have recently started an audit to assess whether EU actions helped to develop an effective single market for investment funds to benefit consumers and businesses, while ensuring financial stability.

MARKUS
FERBER

MEP, Committee on Economic
and Monetary Affairs,
European Parliament

# Capital Markets Union: fewer action plans, more action!

Improving European capital markets has been a long-standing goal of the European Commission and the European legislator. Even before this policy objective has been officially christened "Capital Markets Union", the idea was very much part of the EU's financial services agenda.

Yet, progress has been frustratingly slow. If you look at metrics such as stock market capitalisation as percentage of GDP, the European Union lacks far behind countries such as the US and the UK and even many Asian jurisdictions such as Japan, Hong Kong or Singapore.

At the same time, the European Union's corporate financing model remains heavily skewed towards bank financing while many European retail investors keep having fundamental reservations against equity investments despite fewer and fewer attractive investment alternatives in times of ultra-low interest rates and bond yields.

The United Kingdom, arguably the most liquid and most highly developed capital market in Europe, leaving the EU has dealt another blow to the EU's attractiveness as a financial centre. In the absence of equivalence decisions, the European Union has cut itself and its businesses off from an attractive financing hub - at least for the foreseeable future. In this sense, Brexit highlights that the Capital Markets Union project is needed more than ever.

The general recipe is clear and the most recent Capital Markets Union action plan presented by the European Commission in September 2020 contains many of the right ingredients. Improving cross-border access to company information, facilitating access to public markets for small and medium sized companies and retail investors alike, making long-term investments more attractive and reducing uncertainty in relation to cross-border investments through tax and insolvency harmonisation are no-brainers in theory.

**What is more needed than ever is not yet another rehash of the same ideas in a new action plan, but meaningful execution.**

However, a lack of progress on the CMU is not attributable to a lack of good ideas, but to a lack of execution. Many of the core ideas in the most recent Capital Markets Union action plan are old friends from previous iterations.

What is more needed than ever is not yet another rehash of the same ideas in a new action plan, but meaningful execution of those ideas. Unfortunately, many of the sensible ideas, the Commission and the European Parliament have been consistently calling for have been frustratingly hard to implement in practice, often due to fundamental resistance by the Council that stubbornly refuses to touch delicate subjects such as insolvency law and taxation.

Brexit can be the wake-up call that is needed. The Council's "Next CMU" working group that came up with a few very sensible proposals is an encouraging sign that a more pragmatic approach might finally take shape. The upcoming reviews of MiFID II and Solvency II as well as the Basel III implementation package can be the first litmus test if the Council actually means business in relation to a more ambitious approach to the CMU. It would definitely be time.