CMU ACTION PLAN: PRIORITIES AND DELIVERY MECHANISMS

1. Importance of the CMU for the EU economy

1.1 The CMU is essential for funding the post-Covid recovery

An official stated that capital markets are very important for the recovery process in Europe because they complement banking finance with a different profile in terms of risk appetite. As observed in the US, capital markets incentivise more risk-taking particularly in complex and risky sectors such as technology.

An industry representative noted that the economic situation in Europe is quite severe as a result of the Covid crisis. Europe has done a great deal for its citizens by engaging significant monetary and fiscal policy measures, but the data shows a 3 to 4 pt growth shortfall for Europe in 2021, compared to the US and China (Europe will probably have a +3 to 4% growth compared to 5 to 6% for the US and 8 to 9% for China). Tackling the Covid crisis is about providing a long-term path for the growth of the EU economy, which is where capital markets and the Capital Markets Union (CMU) initiative have a key role to play.

A regulator considered that the CMU is an absolutely essential element for the recovery of the EU economy and also for the European Union itself, because if the European economy does not recover sufficiently, citizens may lose some faith in the European project.

A public representative added that Europe needs to develop and implement the CMU also because it is the only way for providing a larger access to finance and liquidity for small and medium-sized enterprises (SMEs) which are vital for the EU economy.

1.2 The structure and functioning of EU capital markets need improving

An industry representative stated that Europe's capital markets have structural weaknesses that need enhancing for achieving the objectives of the CMU. Capital markets are much smaller and much more fragmented in the EU than in the US. In 2020, looking at primary markets, there were 1,415 Initial Public Offerings (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%. Europe also has a highly fragmented market structure, with more than 250 venues compared to 60 in the US. This fragmentation is due in particular to the effects of the MiFID directive, which has a much stronger impact on Europe's market structure than the CMU. There are issues also in terms of transparency: only 35% of the market is executed on transparent venues in the EU compared to 60% in the US. The ESMA statistical report on European securities markets (November 2020) has shed some light on these key performance indicators (KPIs), which are important to bear in mind.

Answering a question from the Chair about what is needed to keep more growing companies and IPOs in Europe, the industry representative stated that this is a supply and demand problem. In Europe, much of the company funding in the early stages comes at present from foreign investors, which leads these companies either to prepare an IPO in a foreign country or to go directly into a strategic sale. Europe needs to make equity financing more attractive and to create more demand for equity financing and investment. The task is to build a globally competitive financial system and market structure in Europe that is sufficiently transparent and will encourage companies to choose the IPO route in the end. The CMU will contribute to this objective, but MiFID also plays an essential role in this perspective. The simplification of listing that is proposed in the CMU is important, but it is also crucially important that Europe should build trust in secondary markets and that it should foster demand for early stage investments in European companies by asset managers.

An official considered that much also needs to be done for simplifying and reducing the cost of accessing capital markets for companies. Companies are confronted with too many requirements; some are critical for investor protection, but too many of these requirements are bureaucratic and companies, particularly small and medium size ones do not have the resources to handle so many constraints and costs. The role of venture capital investments also needs taking into account and it is important to enhance the bridge between venture capital funding and stock markets.

2. The new CMU action plan and priorities going forward

Panellists generally welcomed the new CMU action plan proposed by the Commission, considering that it is focusing on the right set of priorities and is adopting an appropriate direction of travel.

Two priorities of the CMU action plan were particularly emphasized by the speakers: the implementation of a European Single Access Point (ESAP) for corporate information and the development of retail participation. The importance of further harmonising taxation and insolvency laws at EU level, of developing pension plans and equity investments was also underlined by certain speakers.

2.1 European Single Access Point (ESAP)

Several speakers emphasized the importance of the ESAP project for developing investment in European companies. The Chair noted that a US industry leader had suggested at a previous Eurofi conference that implementing a single point of access to company information is the policy action that would make the most difference to the EU's capital market development because it would allow investors to find more easily the information they need for investing in European companies.

An official considered that the ESAP could be a strong symbol of the effort and willingness of Europe to develop its capital markets. The objective is to build an ecosystem for capital markets rather than just a database, including structured financial and non-financial reporting, good quality research on issuers and tools to ensure a bridge with venture capital. The industry should associate with the public authorities to make sure that the different structural elements that are needed to create this ecosystem can be provided around the single access point.

An industry representative considered that the ESAP is important both for retail and institutional investors, which is why it is critical to have the right data, including information on sustainability factors, which are increasingly important.

A regulator mentioned that while the ESAP is important, one element which may be far more relevant in the long term for developing investment in EU companies is tackling the bias between debt and equity from a tax perspective. This is a national tax treatment issue but it will need to be addressed at some point at the European level.

2.2 Developing retail investment

Several speakers stressed the importance of increasing retail participation in developing capital markets in the EU and discussed the challenges, conditions and tools for achieving this objective.

Opportunities and challenges for developing retail participation

An industry representative stressed that retail participation is low in Europe and has dropped quite significantly over the last 10 years since the financial crisis, from about 11% to 8%, whereas savings are at a record high with the Covid crisis, which makes it a relevant point in time to have this discussion.

Another industry representative noted that it is very important to look at the supply and demand factors and to incentivise retail participation in an appropriate way. There is a retail investment boom in certain EU countries at present due to the context of very low interest rates and to opportunities created by the market downturn at the outset of the Covid crisis. In Germany 17% of individuals in Germany own equities, which is close to the levels observed during the internet boom at the beginning of the 2000s. There is now a great deal of investment in tech companies and also by the younger generation, which is good, but it is important for this participation to be sustained in the longer term. The issues previously experienced by the Neuer Markt are still in everybody's mind. However in the long term, equity investment is the only way to get a good return.

A third industry representative confirmed that there is an emerging trend among the younger generation of investing in equities which can be positive if it is sustained. This trend is not as established in Europe as in the US yet, but it is certainly coming up and will need to be carefully monitored.

A regulator agreed that more retail participation is needed in capital markets, both because of the ageing population and of the funding needs of SMEs. It should go hand-in-hand with improved investor protection however. At present there is a large influx of investment in certain countries but also an increased risk of loss for investors as stock market prices are rising. It is hoped that the upcoming Retail Investment Strategy by the Commission acknowledges this need and aspires to raise the bar for investor protection. Some proposals such as the introduction of a new category of qualified investors or proposals to soften listing requirements for SMEs should also be handled with caution, as they may jeopardize investor protection to a certain extent.

Special attention should also be paid to the cross-border dimension including passporting regimes for retail financial services and the related cross border supervision, because if things go wrong for some retail investors investing in certain funds registered abroad this creates bad publicity for cross-border investment in general. In order to encourage retail investors to enter into cross-border transactions, they should be able to expect similar high quality regulatory and supervisory outcomes across the EU.

The way the market is structured can also be a challenge for encouraging more retail investment in some cases, the regulator suggested. In the Netherlands for example, most retail investors go through pension funds, so there is a limited number of individual investors and limited leeway for developing their participation further.

Another regulator added that there is a risk in encouraging at the same time retail investment and more capital market financing for SMEs e.g. by lowering disclosure constraints in prospectuses. That can be a danger for investors, because SMEs are typically more risky and many do not have appropriate research coverage.

Conditions and tools for developing retail investment

An industry representative stated that retail participation needs to be guided in order to obtain a long-term engagement of retail investors in capital markets. The European long-term investment fund (ELTIF) is a perfect concept for supporting this objective, but so far it has not been a success with only about 27 ELTIFs launched in Europe and a cumulative asset base that has not gone beyond €2 billion. A review of this framework is much needed based on an assessment of the reasons for the limited success of ELTIFs both on the supply and demand sides. On the supply side ELTIFs need to have the right eligible assets. This includes allowing investment in SMEs with appropriate limits, alongside real estate, sustainable assets and social infrastructure projects. There is also a need to reduce the barriers on the demand side.

The Chair observed that the pan-European personal pension product (PEPP) could be another instrument for channelling retail investment. The industry representative agreed that pension products are relevant in this perspective, because on one hand there is a need for more financing to go through public and private markets, and on the other hand there is a very strong sense that investors need to be protected, as mentioned by previous speakers. The way to solve this puzzle is not to over-burden the regulation that relates to the direct engagement of individuals in capital markets, but to build a pension system that is tightly regulated, with second and third-pillar solutions, in which people can regularly invest and that provides a default solution. An ELTIF directly targeting SME funding would be an excellent default solution for a European defined contribution (DC) scheme, the industry speaker believed, filling a missing link between the needs of retail investors and the funding needs of SMEs. However, it is currently not that easy for the PEPP to work because PEPP products need to be registered in multiple EU jurisdictions due to domestic specificities. Pension regulation is indeed a national matter and there are also different types of tax treatments across Europe.

Building trust is also essential for fostering more retail participation in capital markets, two speakers stressed. One way of increasing trust, an industry speaker suggested, would be to provide individuals with the possibility to conduct financial health checks in a neutral way on a regular basis, as a social service, which could be a basis for encouraging more retail investment. This could be done through the digital avenue potentially. A regulator considered that harmonising capital market rules throughout Europe and increasing supervisory convergence is also essential for reinforcing trust. Moreover distribution rules need to ensure that advice is delivered in an independent way and in the interest of clients. There is also a need to think about professional investment management as a conduit to channel increased retail participation, professionalising research, and also providing sufficient diversification in order to make retail participation a success.

An industry representative added that the engagement of retail investors in capital markets is an area where care must be given to avoid a gap between the conceptual agenda of the CMU and the actual implementation in the member states. The European authorities need to explain clearly to local political decision-makers the objectives of the CMU in order to obtain sufficient local support for the measures proposed in this area.

3. Items that could be better covered in the CMU action plan

Some panellists suggested that further work on the supervisory architecture in Europe and on the regional dimension would support the CMU.

3.1 Work on the supervisory architecture

A regulator stated that the work on the supervisory architecture could be better addressed in the context of the CMU. For EU markets to function effectively, high quality supervisory outcomes are required, regardless as to whether the supervised entity (firm/business) is primarily offering services on a local or cross-border basis. The geometry of supervision should follow the geometry of the business, which is not currently the case, as there are dozens of sectoral supervisors. There are four criteria for defining whether supervision should be centralised or executed more locally: whether the activities are cross border; whether the risks are cross border; whether the rules are harmonised; and whether there is a risk of regulatory arbitrage. If these boxes are all ticked then there is a strong case for a centralisation of supervisory tasks. This would in particular logically lead to the centralization of certain supervisory tasks concerning the wholesale side of the capital markets. In any case further work to strengthen supervisory convergence is necessary.

In order to supervise effectively cross-border retail financial services, the regulator stated that specific attention must be paid to issues related to the current passporting regimes. It is important for the Commission to study the positive and negative effects of the current passporting system and to look for solutions that will empower national competent authorities (NCAs) to protect investors domestically. While being a cornerstone of the single market, the current system – with 'home' and 'host' responsibilities – may imperil the effective protection of investors that are engaged in cross-border transactions. Cross-border problems require cross-border solutions and individual supervisors are not always able and in the position to supervise effectively these issues, as there is an incentive to look first after one's own citizens and a possible cultural bias against foreign legal systems. Convergence also has its limitations, as it will not make full use of the potential efficiency and effectiveness gains, or fully eliminate the risk of regulatory arbitrage. Therefore, for a well-integrated and functioning CMU it is key that ESMA and the NCAs collectively work out an appropriate approach for addressing cross-border risks. A restructuring of supervision, rather than a full centralisation would be needed, providing appropriate incentives for the various supervisors involved.

A regulator agreed that there are merits to centralised supervision and that criteria need to be defined. This has been proposed in the report of the CMU High Level Forum (HLF) in particular. However care must be taken when using the Banking Union (BU) as a reference for defining the type of supervision that is needed for supporting the CMU. The CMU is indeed attempting to address a different problem from the BU, which is developing the ability for European companies to attract more investment from other Member States. That has more to do with incentives i.e. the incentives for companies to go public and the incentives for investors to broaden their investment horizons. Central supervision would bring some benefits in this regard, but it would not solve the problem entirely, which is why the different actions prioritised in the CMU action plan are needed.

3.2. The regional dimension

An official considered that the main missing block in the Commission's CMU action plan is the geographical aspect. This was pointed out in the report recently published on the CMU by the European Court of Auditors (ECA - 'Capital Markets Union: Slow start towards an ambitious goal') and was recognised by the Council in its March 2021 conclusions.

The architecture of the EU capital markets needs to be reconsidered, the official suggested, because there is a strong divergence at presence in the way capital markets operate across Europe and in the possibility for retail investors and SMEs to participate in capital markets. There are legal barriers such as differing insolvency laws and taxation rules and also cultural differences between the member states that need to be considered, such as different perceptions of insolvency practices. Concentration is sometimes needed at EU level for better market liquidity, but SMEs in the Baltics and the Viségrad countries for example need to be offered equal opportunities, which is not the case at present. The characteristics of the capital markets in different member states should be further analysed by the Commission in order to identify what legislation is needed and what is not. Regional initiatives such as the consistent legislation established in the three Baltic countries for covered bonds should also be considered.

3.3 A more explicit priority for insolvency and taxation rules

A public representative considered that three main obstacles need to be tackled for developing a true CMU and enhancing the competitiveness of European capital markets at the global level: single supervision, insolvency laws, and the harmonisation of taxation. Europe is indeed competing in a global world and therefore needs to be more attractive and accessible for those seeking options for investment.

Referring to the comments made by a previous speaker, the Chair observed that the local and regional dimensions of the European capital market ecosystem are important to consider and this has been recognised in particular by the CMU HLF. At the same time there needs to be a corpus of rules in certain areas that allow capital to flow freely across the EU and facilitate a common approach for investors. This is the case of insolvency and taxation procedures. The problem with insolvency rules in particular is that international investors who are looking to invest in Europe are put off if they see challenging or lengthy barriers and the problem is increased if rules differ across Member States.

4. Next steps regarding the implementation of the CMU and challenges to overcome

An official stated that that the EU Council Presidency is working on the CMU action plan that was presented by the Commission at the end of 2020 for developing capital markets in the EU. A set of key performance indicators (KPIs) will be developed in particular in order to facilitate the monitoring of progress. There is willingness at the highest level in the EU to strengthen capital markets and momentum is building up around this objective, because member states see the link there is between making progress on the BU and on the CMU. Capital markets can indeed help to complete the structure of the financial system by providing sources of financing for investments with a higher risk profile. There is therefore an increasing position in the Council that the two objectives of the BU and the CMU should go ahead at a similar pace. Regarding the BU, the expectation is that a roadmap is going to be approved by the end of the first half of 2021. The presidency is working on the different elements that are needed for completing the BU such as EDIS, cross-border integration, the crisis management framework, the sovereign risk exposure of banks and the approach regarding the small and medium banks.

An official noted that if the BU and CMU are compared it looks as though the BU is much better accepted and understood by the public, but at the same time Europe is much more advanced in the CMU in terms of ideas. The prioritisation that was established by the Council is the right way forward. What remains to be done is defining the responsibilities in terms of implementation. The ECA report on the first stages of the CMU identifies a gap between the ambition and expectations put forward regarding the CMU and the ability of the Commission to actually foster progress in the different areas of the CMU. This gap should not be reproduced in the further steps of the initiative.

A public representative noted that the Commission, the Council and the Parliament have all displayed a strong ambition regarding the need to make the CMU a reality, which is very positive. There were initially disagreements among the different political groups in Parliament mainly about retail investor protection issues and the risk of deregulation that certain simplification measures of the CMU may entail, but compromises were found. The demand for a high level of protection of retail investors however remains a challenge for the CMU because in some cases it may create more obstacles than deliver incentives and simplifications. There were also heated debates among the EU institutions and market stakeholders concerning supervision and insolvency and taxation rules but agreements were also found. Now there is a common willingness to make the CMU a reality.

Ambitious and concrete deadlines are however needed to achieve the 16 measures included in the CMU action plan, the public representative believed, because these have not yet been precisely defined by the Commission. The speaker moreover had doubts about whether there is such a common position amongst all member states regarding the BU, which would be essential for making progress on this initiative.

The Chair agreed and expressed concern about the Council's conclusions from December 2020 which have pushed forward certain actions of the CMU action plan to the medium term with no clear deadline. This includes the work on insolvency rules, which seems endless.

An industry representative stated that the commitment displayed by the public authorities and different stakeholders for the CMU is very important for moving the initiative forward. The main challenge for the CMU concerns its execution and being able to implement it in a timely manner with sufficient granularity. An effective collaboration between public and private sector institutions is essential in this perspective, as well as a proper balance in terms of obligations and responsibilities. One major challenge in this respect is that many critical actions for the CMU, such as taxation or pension systems, are within the sovereignty of EU member states, which means that the commitment of individual member states is essential for the success of the CMU. The coordinated political will expressed by the EU institutions is a major step forward, but Europe will need to help generate sufficient momentum in the implementation phase and make sure that the key priorities for achieving the CMU are appropriately implemented.

There also needs to be a sufficient protection of intra European Union investments, the industry representative emphasized following the recent proposal of the Commission that aims to clarify the rules that protect and facilitate investment between EU countries and improve dispute settlement. This is critical for a successful implementation of the CMU, the industry speaker concluded.