CMU ACTION PLAN IMPLEMENTATION: HOW AND BY WHEN CAN DECISIVE PROGRESS BE MADE?

1. Status of CMU implementation

1.1 Importance of CMU for the EU economy

A policy-maker stated that the Capital Markets Union (CMU) is as important as it was when the project was launched back in 2015 and for the same reasons, including complementing the Banking Union (BU) and developing alternative sources of finance. In the current context there is also the objective to support the recovery from the pandemic. Additionally, the massive funding needed for the green and digital transition has to occur also via a well-functioning, integrated capital market. The CMU also plays a key role in the open strategic autonomy objective of the EU. The core of this objective is that the world is inevitably more fragmented post-Brexit, and geopolitically it is more complex than it has been for some time. In this context ensuring the resilience and stability of the EU financial system is essential and this notably requires the development of European capital markets.

An official agreed that CMU may support the open strategic autonomy objective which for the EU means having the choice of financing sources and being able to find them within the EU. Another official added that CMU is urgently needed, not least because of Brexit, but also because of COVID and the recovery which require significant funding resources.

An industry representative noted that Europe needs powerful and deep market liquidity to allow companies to access the best terms for capital. In order to support the post-COVID recovery, there cannot just be reliance on NextGenerationEU (NGEU) debt and monetary policy. Developing capital markets, and particularly equity markets, at a sufficient scale for them to be competitive at the global level is also essential.

1.2 Progress in the implementation of CMU action plans

A policy-maker highlighted that all of the legislative proposals that were foreseen in the 2015 CMU action plan have been delivered or adopted, with only one exception. The work is not finished however and several new legislative proposals are coming forward that will be useful for CMU. These include the review of Solvency II, ESAP (the European Single Access Point), which will make it easier for investors to find data on EU companies, the review of the ELTIF framework and also the reviews of MiFID and MiFIR, which are very relevant for CMU. In addition some improvement can be seen on the ground, as shown by the CMU indicators which are regularly published.

An official commended the Commission for putting in place key performance indicators (KPIs) to measure the progress of CMU. This is something that was lacking at first. Measurements will be annual and long-term.

Another official noted that the Commission's CMU action plan is comprehensive, and Germany made it a Council Presidency priority to prepare Council conclusions and to reach consensus among member states in December 2020 on the order in which the important building blocks of CMU should be worked on. That is a very good starting point, and now is the time to do the legislative work. The Chair agreed that these Council conclusions reached in December 2020 are an important step forward, but regretted that some important actions regarding insolvency or tax procedures in particular, which are important for the development of cross-border investment, were pushed forward to the longer term.

The second official considered that the Council conclusions of December 2020 on CMU are already ambitious and it is encouraging that they were endorsed by the EU political leaders. For topics outside the remit of Finance Ministries such as insolvency legislation, making progress is quite challenging. When the Council conclusions were being prepared in the previous months, that was one of the most sensitive issues. There is no appetite among the justice ministries to harmonise insolvency legislation. The prevailing view is that basically all member states have the world's best insolvency legislation that cannot be modified. That makes it very difficult for finance ministries to start a discussion on this topic.

An industry representative warned that the pace of CMU delivery is insufficient and that there is a great deal of frustration concerning the CMU within the financial industry. The initiative has so far resulted in the delivery of fragmented and partial measures and it is difficult for most stakeholders to grasp the overall picture of what is being achieved. This explains the lack of political drive in the implementation of the CMU. While politicians understand the importance of the CMU as an objective, they find it difficult to get actively involved in its implementation because of the complexity of the project. Another industry representative agreed that there is frustration at the slow progress of the CMU initiative. While it is easy to subscribe to the 16 actions that have been listed as part of the latest CMU action plan and that aim at increasing SME access and retail participation in particular, it is difficult to identify real game-changers for the development of EU capital markets.

2. Opportunities and trends supporting CMU

2.1 Opportunities for the development of capital markets in the post-COVID context

An official highlighted that the starting point of EU27 capital markets is quite low. The first objective should be to develop these markets, before integrating them in a union. The current recovery phase and the longer term challenges regarding the green and digital transformation are an opportunity to develop EU capital markets further in order to bring more capital and private money in for the investment needs of Europe and for the future growth needs of all member states.

An industry representative stated that there is an enormous opportunity for Europe to build up its capital markets in the current post-COVID period which requires significant investment. There is also broad consensus in the population that the move to a net-zero society must be tackled now and there are huge savings pools in Europe that may contribute to this objective.

Another industry representative agreed that the vast European savings base should be taken advantage of for developing EU capital markets. Certain statistics suggest that Europe's capital markets also have a significant catch-up potential in terms of integration, size and depth compared to the US. In Europe, there are 22 different stock exchange groups, 35 different exchanges for listings, 41 exchanges for trading, and 40 different central counterparties (CCPs) and central securities depositories (CSDs). In the United States there are two stock exchanges for listing, 16 stock exchanges for trading, one CCP and one CSD. There is roughly $15 trillion of gross domestic product (GDP) in the EU, and $21 trillion in the US, so the numbers are very similar. Europe has a larger population than the US, so it has some catch-up potential and is nowhere near the capital markets development needed for its economy.

A policy-maker cautioned about such comparisons because US capital markets have not developed in the same way as European ones historically and the EU is not integrated in the same way as the US. For example the pension system is set up in a different way in the US and is capital market-based and that is not something that can realistically be copied in Europe. The industry representative responded that such differences should not be a reason for minimising the ambitions of capital market development in the EU. In addition the fundamentals of the market are similar: 'a bond deal is a bond deal'. Goals should therefore be established for European capital markets that are appropriate for the scale of the ambition desired.

2.2 Main market trends supporting CMU

An industry representative advised that there are underlying trends on which the CMU could capitalise going forward and that have accelerated at unexpected speed with COVID. These trends include the growth of retail investment, sustainable investing and the increased demand for private assets. In terms of the retail space, there is an entirely new ecosystem emerging following COVID, with new online brokers in particular which facilitate access to capital markets and gamification trends. Retail participation is a good thing, but much of it is pure speculation. People mainly rely on different forums and YouTube channels for financial information. There is a need for policy-makers and regulators to address these developments and also for renewing the regulatory frameworks, because innovation is running ahead. This trend is here to stay, and it is expanding into other places such as cryptoassets which are largely unregulated.

Secondly there is broad agreement that the demand for sustainable investments is the path to a zero-emissions society, the industry representative emphasized. Demand for these assets has been skyrocketing and now 64% of investments in asset management products are going into sustainably labelled products. More transparency and disclosure is needed around what sustainability is to avoid greenwashing. Providers have adopted the Sustainable Finance Disclosure Regulation (SFDR), but this needs to happen quickly because the assets are moving.

Thirdly, on private asset demand, interest rates are at zero and will remain at zero for the foreseeable future at least in Europe. The demand for private assets is going up daily in this context. Investors indeed realise that traditional assets such as fixed income, real estate or even blue-chip stocks are no longer providing sufficient income or return and the place to move to is private assets, which is a huge universe. There are many more private companies than there are public companies, but it is a space that is not easy to access from a regulatory or sophistication perspective. Finally, digitisation is going to be essential for increasing retail investment. It is a good thing, but it needs to happen in a controlled way.

A policy-maker agreed with these trends which are here to stay. The pandemic, resulting in people spending a great deal of time at home, in front of a screen, is one reason for the development of online retail investment in recent times. Another reason is the negative rate environment, which means that traditional savings accounts no longer produce any interest and that savers are looking for other assets that may provide yields. In terms of crypto assets, some regulatory actions are being taken by the Commission with the Markets in Crypto-assets (MiCA) and the Digital Operational Resilience Act (DORA) legislative proposals.

3. Way forward for the implementation of CMU

3.1 Key priorities going forward for CMU

Some panellists highlighted priorities in the action plan published by the Commission in September 2020. An official considered that reviewing Solvency II is key to bringing in more capital by encouraging insurers to be more active on capital markets. Legislation cannot solve the issue by itself, but it can give a positive signal to insurance companies to invest in capital markets. The European Long-Term Investment Fund (ELTIF) can also do that, but the starting point is currently quite low. It is also important to have an efficient market infrastructure and to be careful about the competitiveness of financial actors.

The official added that securitisation is also a very important topic for bringing more capital into European markets. The EU simple, transparent and standardised (STS) framework is appropriate and the criteria are relevant, but it remains quite penalizing from a prudential point of view compared to other products. In addition, if a framework designed for US markets is applied, one consequence could be that European markets start to look more like US markets.

Another official agreed that it is very important to work on enabling insurers to make more equity investments within the risk-based framework of Solvency II. Another key objective for the coming years is to improve the access to finance and to the data needed for investments, for which the ESAP proposal can play an essential role, proposing to implement a unique access point at the EU level for corporate and SME data. At the moment it is very difficult to access this data in different EU member states, to compare it and then to make investment decisions. Listing rules also need to be streamlined, especially with regard to small and medium-sized enterprises (SME), for which it must be easier to go to the market. Market structure is a further issue to be worked on, the official suggested. Some issues were addressed in the capital markets recovery package. In addition to this a strong focus is needed on equity markets in the MiFID II review. There has to be a level playing field between the different trade execution venues. With regards to bonds and derivatives, the issue is harmonising the transparency requirements, and also simplifying the waiver regime. The cost of market data also needs to be addressed.

Other panellists were in favour of a restructuring of CMU around a smaller set of key priorities that would be easier to pursue and communicate. An industry representative suggested there should be a fundamental 'reboot' of the CMU to refocus energy on a much more limited set of priorities. Three regulations at most should be focused on, and not directives, because a CMU needs identical rules within the capital markets. When rules are merely similar they are different, and if they are different then it is not a union. These regulations should not reinvent the wheel but focus on some key actions needed to develop capital markets in Europe.

The first item is the prospectus. There should be a single prospectus with a single outline, eliminating gold plating. One feature of this prospectus should be that it decides on the proportion in the national language and the proportion that can be in another European language. It is critical to have the same rule so that the rest of the world will recognise the prospectus. The second regulation concerns reporting. In an ideal world, there would be a single, universal document format across the continent. This is not easy to achieve, but the reporting for non-financial data, which is in the pipeline could be a starting point. This could be an important accelerator for the development of ESG investment. The third regulation is more ambitious and concerns insolvency rules. These rules which have existed for 1,000 years are practically impossible to converge, even if they are more similar than might be thought. An alternative could be to create a European credit instrument with a sui generis set of insolvency rules, through which a borrower from country A can borrow from country B and take securities in country C, and then those securities would be enforceable against a third party e.g. when they are publicised in a distributed ledger technology (DLT) single register through a common set of rules. Suddenly all of the professional users would have a single European credit instrument. If these three tangible changes can be delivered, then the markets will realise that life can be made simpler.

Concerning the communication around the CMU, the industry representative suggested that European political leaders should be told that they are not going to achieve CMU but the Schengen of transforming saving towards economic growth. This could potentially motivate political leaders because citizens like Europe when it delivers fundamental improvements in terms of integration such as Schengen, the euro or the single market. This idea could also simplify the debate around central supervision. Currently, when people are against central supervision it is not known whether that is because it may be inefficient or because they want to keep things at home. The argument is that regulation is not convergent enough or not sufficiently similar for single supervision to be possible. The three regulations mentioned above could constitute a basis of identical rules for making central supervision possible.

Another industry representative agreed about the need to be specific in the CMU action plan, and to tackle a few objectives upfront. ELTIF is one of them, but it is not feasible currently. The minimums have to be lowered. An evergreen structure is needed in terms of the redemption structures, and more than 30% of user-type products need to be allowed to go into that vehicle. ESG data transparency is also essential and is a lynchpin of the desired outcomes in terms of sustainable finance. MiFID should also be updated to allow digital advice and hybrid advice.

A third industry representative suggested that Luxembourg law could become the predominant law for credit instruments in the EU since the NGEU programme has chosen Luxembourg law for some of its issuance. This is a similar idea to the sui generis European credit instrument proposed by the previous speaker, but would not require defining a new law. In addition to these 'tactical' approaches, there is a need to step back and define a political objective for CMU that is ambitious, attractive enough and that can be easily communicated. What may be needed is a consolidation of more European capital markets in order to create more depth and access for the largest companies. This would be a similar intention to the one that motivated the introduction of a monetary union in Europe. There should also be consideration of the most effective ways for Europe to create deeper and more integrated capital markets, in order to make its economy more investable for European and foreign investors. This may require revisiting current approaches and trade-offs consistently with the realities of the European market and economy. Hubs, for example, could be created for achieving a greater depth of capital markets activity. These hubs could be agreed between different member states to create specialisms by country, but ultimately still retaining a certain amount of capital market activity in countries, while creating that greater depth.

A policy-maker observed that one challenge with CMU has always been that it is not about one measure or putting one new institution in place. Many things have to happen in parallel, whether that is legislation or action on the ground by market operators. For a well-functioning CMU, areas that go beyond pure financial market legislation will need to be looked at as well, such as insolvency laws or taxation, which will be challenging. The Commission has started using regulations more in recent years. Previously the entire financial services acquis was directives. Sometimes there are legal reasons for using directives, where the legal basis in the treaty foresees only directives, but in most areas there can be regulations or directives, and that is also why we have now MiFIR alongside MiFID and CRR in addition to CRD. However, using regulation also means less national discretion and more common rules. Supervisory convergence is also very important for CMU. The issue is trust between the national competent authorities and the European supervisors. The right balance has to be found. There has been much progress since the European Supervisory Authorities (ESAs) were established 10 years ago, but there is still some way to go.

3.2 The need to build stronger political commitment around CMU

An official stated that CMU has to be politically driven. It is about trying to have a consensus on the need to enlarge and develop capital markets, and enlarging capital pools for the benefit of all, and not about competition between Member States. There are many objectives in the Commission's action plan. Some will probably have more impact than others, but overall it is very important that there is sufficient ambition for each objective, which was not achieved after the first CMU action plan where some proposals were not taken sufficiently onboard.

The Chair suggested that the Commission could press the Council and Parliament to set delivery deadlines, to have a tripartite institutional agreement between the Commission, the Parliament and the Council on a framework for delivery and to agree on fast track procedures under the treaty to accelerate certain items. That may have a snowball effect demonstrating that things are happening. A policy-maker noted that there is a gap between the general political commitment to CMU and the progress made in the implementation of the initiative. A stronger dynamic needs to be built around certain sub-components of CMU and the importance of progressing quickly on CMU needs to be better communicated to EU political leaders. However, deadlines may not be that helpful, because the Commission cannot impose deadlines on the co-legislators, and strict deadlines may create deception if they are not fully respected. Regarding fast-tracking, there can be a political discussion and debate with the co-legislators to ask for as decisive action as soon possible, though that is difficult to realise outside of crises.

The official emphasized the importance of ensuring that ministers and political leaders understand that CMU can be a win-win initiative. Ultimately, it is not about the relative strength of financial actors in each member state but the strengthening of the financing of the overall EU economy and its positive consequences on the growth of capital markets in each member state. There is a need for simple facts and examples. All member states have corporates that need financing. Scale-ups in particular are an eloquent example for political leaders. Many member states are concerned that their successful companies are seeking money outside the EU for their growth and ultimately growing outside the EU. The question is therefore how to develop large pots of money in Europe that may finance these companies. This includes developing the capacity for European insurers and pension funds to invest in such private assets. Once this has been done asset managers will fill the gap. Some member states such as France have started working on this issue, but a European approach is needed. There are also issues related to fragmentation and the different interests of member states. It is important to give signals to political leaders so that they understand what can be achieved with a common European approach.

An industry representative considered that the political commitment that may be needed for achieving the CMU has to be expressed concretely. The starting point is that Member States have very different positions in the financial sector with some having a large financial industry and other being finance takers. Some also have an ambition to have Europe in a position to transform the strong European household savings into strong European investment in strong European blue-chip companies, but this is not the case for all. Aligning those different interests is challenging. Politicians and elected leaders need to understand about the objectives and benefits. Making CMU simpler and more focused is paramount. Secondly, they need to take into account the benefits of CMU for citizens and corporates, which requires focusing on actions that simplify their lives and increase their competitiveness. Thirdly, there is a need for a new narrative connected to the big picture of what we want to achieve with the CMU because nothing can be changed without storytelling in a democracy. A strong narrative helps political leaders to move forward whereas a weak narrative creates resistance to change. Resilience and recovery are probably the best objectives to make the CMU more relevant and justify a reboot of the initiative.