CMU: state of play and way forward

1. Update on the implementation of CMU

1.1 Progress made and proposals underway

Panellists agreed that the Capital Markets Union (CMU) project is progressing. A policy-maker noted that the first two action plans published in 2015 and 2017 have been implemented and the focus is now on the implementation of the third action plan of 2020, which encompasses 14 additional measures. In November 2021, a first package of initiatives was proposed for implementing this action plan with four important initiatives currently under discussion.

First, the European Single Access Point (ESAP) project aims to provide investors with all necessary information at one point at no cost, making investing easier and cheaper. Second, adjustments to the MiFID II / MiFIR[1] frameworks are under discussion, including the proposed implementation of a consolidated tape, which will introduce post-trade transparency. Pre-trade transparency can be considered at a later stage. Third, the European Long-Term Investment Fund (ELTIF) fund framework will be modernised. Uptake has been very limited so far and it is hoped that changes to the regulation will make it more attractive and will allow the collection of money that can contribute to long-term sustainability objectives. Fourth, the rules of the Alternative Investment Fund Managers Directive (AIFMD) will also be enhanced to ensure its continued success. Other initiatives in the pipeline include a framework on open finance to facilitate the reuse of data by financial institutions and the circulation of investor and client information, a review of the Central Securities Depositories Regulation (CSDR), the publication of a retail investment strategy and a reconsideration of insolvency rules and withholding tax. This latter area is very challenging and has been discussed for many years, but the time is now right to address it with some targeted adjustments.

Some additional comments were made by the panellists on the ESAP proposal. An official stated that the ESAP project will address the lack of adequate investor information and the fragmentation of accounting standards used by small and medium-sized enterprises (SMEs) which results in differing presentations of financial accounts across EU countries. The International Financial Reporting Standards (IFRS) that exist for public companies are not used for non-listed companies, which is a major obstacle for auditors and investors in a cross-border context.

Another official clarified that the general IFRS can be used by SMEs that do not invest in derivatives and are not a part of mergers, but this is not the case at present. The official added that the revision of the Capital Requirements Directive (CRD)[2] concerning SMEs is also welcome, as well as the referral rule proposing that if a bank declines a loan to an SME, the SME requesting the loan should be directed to alternative funding providers.

1.2 Speed of implementation of the CMU

A policy-maker stated that the pace of progress on the CMU has been steady. It was clear from the beginning that the CMU project could not be delivered overnight. It is hoped that political support will be maintained for the upcoming proposals and that, ultimately, all the objectives agreed at the outset of the initiative will be reached.

An official agreed with the characterisation of 'steady progress'. While many actions are in the pipeline, it will take many decades to build a true European capital market and there will always be room for improvement. Realism and pragmatism is needed in this respect.

A regulator agreed that building the CMU is a long journey, but warned that the credibility of the whole CMU project could be at stake if some progress is not made sufficiently fast from now on. The proposals already on the table must be delivered rapidly, with some compromises if necessary, otherwise discouragement may gain. The recent European Court of Auditors report on the performance of the EU single market for investment funds, which is thought to be the most integrated part of the EU capital market, concludes that, although a single market for investment funds has been established with passporting, true cross-border activities and related benefits for EU investors remain limited. In addition fund supervision and investor protection are considered to be insufficiently effective at the cross-border level. This illustrates the scope of progress still required to achieve a true CMU.

An industry representative had mixed feelings about the progress on CMU. Nobody challenges the need for CMU and for a more integrated capital market to support the post-Covid recovery and there is an alignment on the sense of urgency of this project, which is positive. There has also been tremendous growth over the past few years in capital market volumes in the EU and also significant progress in the market structure, with important developments such as TARGET2 Securities (T2S) and related harmonisation efforts, the implementation of the CSDR, extensive efforts on shareholder transparency and settlement efficiency and delays, as well as an increase in

1. Markets in Financial Instruments Directive (MiFID)/Markets in Financial Instruments Regulation (MiFIR).
2. Aiming to avoid undue impacts from the implementation of Basel III on long-term SME equity investments by banks and on banks' and investment firms' market-making activity.

resilience and risk management requirements. However, despite calls for a step change, there is a feeling in the industry that the impact so far of the CMU initiative on securities markets, beyond these actions which were already in the pipeline mostly, is too limited and that the pace of change is too slow.

The industry representative moreover suggested that the international competitiveness of European financial institutions and market infrastructures is an objective that should be more prominently put forward in the CMU. There are some achievements in this area. More than one third of euro denominated corporate bonds issued are from companies outside of the EU 27 countries, showing the attractiveness of the euro and related bond markets. Half of the holdings in euro-denominated debt in the books of Euroclear for example, a major European CSD, are held by non-EU investors. The Next Generation EU (NGEU) programme has also attracted significant interest from international investors. However international competitiveness is a permanent challenge and it is important to monitor closely the potential impacts in terms of competitiveness of the implementation and recurring costs of the capital market regulations proposed.

An industry representative also welcomed the general direction of progress on CMU. The ESAP, the consolidated tape and ELTIF are all very important topics. However, there is execution risk. As mentioned by a previous speaker, proposals on the table must be implemented as soon as possible to maintain the overall confidence in the project, because there is a risk that changes in the market will outpace regulation and may make part of the project irrelevant by the time it is implemented. Three examples were given to illustrate this. First, inflation may have significant impacts for investors. The entire regulatory framework has been built around cash being the safest asset, which no longer applies in a context where households may be losing 5 to 8% per year from their purchasing power if money is held in cash deposits. This should be considered in further regulatory initiatives. Secondly, there is a very strong demand for more sustainable investments, but EU regulation lags behind with no common thread for the time being. There is still a lack of clarity around some of the measures and categorisations of sustainable investments in the Corporate Sustainability Reporting Directive (CSRD). Consequently, investors still do not have the relevant corporate data and are forced to make decisions based on very poor information. The Markets in Crypto-assets (MiCA) proposal on digital assets is a third example. The proposal is welcome, but it focuses on stablecoins and tokenisation, and is silent about decentralised finance (DeFi), the fastest-growing segment in digital assets at present.

A regulator agreed that DeFi is not explicitly covered in MiCA, but it can be addressed indirectly with the regulation of stablecoins, which are key for the functioning of DeFi platforms, and with rules imposed on digital asset service providers. Fine-tuning the Level 2 requirements of MiCA will be essential. The pragmatic approach would be to finalise MiCA and then address DeFi in a second step, because otherwise that may delay MiCA significantly.

2. Further steps concerning retail investors and SMEs

An industry representative considered that there is insufficient ambition in the CMU on retail investment and SME funding, which are key areas for the growth of the EU economy. SMEs that are eventually listed on a public market create three to four times more jobs than other similar companies. Getting access to capital allows them to expand beyond their home country into the rest of Europe and in some cases globally. In addition capital can be raised in several stages to support their growth. The planned Retail Investment Strategy and Listing Act are relevant objectives, but more needs to be done to support these two areas and a stronger priority should be put on these actions. While proposals for a consolidated tape for example are welcome, they will not be decisive for developing EU capital markets.

Rather than waiting for the EU to make progress with its policies, market stakeholders should take action themselves, the industry speaker suggested. Sweden, where the whole financial industry joined forces to promote equity financing for SMEs, is a convincing example in this respect. An SME market, Nasdaq First North, was built in Sweden 10 years ago, where 219 companies are now listed and 174 new IPOs were recorded last year, among which more than 100 were SMEs. Listing procedures were simplified and the prospectus was replaced for certain types of companies by a shorter company description, cheaper and faster to produce. More than 100 of the SMEs listed on the First North market have been lifted to the main stock market, growing from being small SMEs to mid or large-cap companies, which is a significant achievement.

A policy-maker indicated that proposals for a Listing Act and Retail Investment Strategy are upcoming. The Retail Investment Strategy proposal will include elements on disclosure and reporting, investor protection and also financial literacy. The objective is to offer every investor the opportunity to be better informed. While education is outside the remit of the European institutions, there is scope for supporting the Member States in putting in place actions for improving financial literacy.

The industry representative agreed that initiatives to develop retail investment are important. Time spent by the financial industry educating retail investors in the Nordics has led to high levels of retail participation. As a result, Sweden probably has the most sophisticated retail market in Europe and a high level of retail participation in SME equity markets. 40% of the capital in the First North SME market comes from retail. Retail investors are also a significant part of liquidity and price formation in SME markets now, with trading in SME stocks gaining in popularity, which enhances the level of confidence of investors in the market. Another factor is that transactions are conducted in a very transparent way, with retail investors putting their orders in through their bank's broker, who then sends them directly to the exchange.

An official considered that building confidence is essential for achieving the objectives of the CMU. There are important institutional investors such as pension funds and insurance companies, but they hold the money of retail clients who make the decision to invest in capital market instruments and need to be confident in the market. With the pan European pension product (PEPP), this will be even more the case. The confidence of retail investors diminished following the 2008 financial crisis, but Covid has led to a rise in retail investment. With the current low interest rates, retail investors are looking for yields and this will continue with inflation. The capital market however has to compete with cryptocurrencies and demonstrate that there is an advantage in investing in a regulated market. The MiCA regulation is also essential in this regard for tokens which are not securities.

The official stated that enhancing financial literacy is also important for entrepreneurs, meaning the CFOs or CEOs of SMEs, who need to be educated about the capital market and its possibilities, whereas the CFOs of larger companies usually have sufficient knowledge about this. Together with the European Commission, the Czech Republic Ministry of Finance for example has created a website outlining how SMEs can be financed in the capital markets. SME go through different stages: personal funding and crowdfunding, then venture capital and private equity; and finally public markets. The funding can be made in equity or bonds, but it is usually easier for SMEs to issue bonds in the first place, because it is psychologically the same as taking out a loan. Equity is different from a governance perspective, which is a potential obstacle to the development of equity financing that needs to be overcome.

3. Main pending issues and remaining challenges

The panellists mentioned a number of topics related to legal and fiscal barriers and EU-level supervision where further focus would be needed in the CMU initiative. The Chair suggested that increased attention must also be paid to securitisation and pensions. The situation in EU securitisation markets is worse than it was 15 years ago, despite the implementation of a new EU regime of simple, transparent and standardised (STS) securitisation. On pensions, which are one of the great strengths underlying the US capital market, further consideration is needed on how to build a deep pool of savings for long-term investments. At present it is uncertain whether the Pan-European Personal Pension Product (PEPP) will work.

3.1 Legal and fiscal barriers

An official noted that there are many language, cultural and legal barriers to achieving the CMU. Deeply entrenched legal cultures in member states concerning for instance financial reporting standards or the management of insolvency procedures, must be addressed. Some of these issues are outside the responsibility of finance ministries and are covered e.g. by ministers of justice, who tend to have different priorities than finance ministers in relation to capital markets. Reconsideration by the Commission of the possibility to enhance the consistency of insolvency rules is key, because there is a clear link between creditors' rights and capital provision and in domestic laws there are very different ideas about the appropriate balance between the rights of creditors and debtors across the EU. Reform on this point is difficult, because some of the ideas are very deeply entrenched, however real progress on the CMU cannot be made without tackling this issue. Tax harmonisation is an even more difficult area on which there are few initiatives. Even harmonising the procedures (rather than the level of taxes) such as the withholding tax procedure is hugely controversial. A policy-maker indeed explained that unanimity is required to address the issues around taxes at a European level.

An official commented that the Czech Republic is keen to open discussions on the long-standing issues of the harmonisation of securities law, in addition to insolvency rules and taxation. This should not be a major challenge, the official felt, because it could be achieved by implementing the Hague Securities Convention and the Geneva Securities Convention as EU regulation. The Giovannini report also provides useful guidance in this regard. The harmonisation of corporate taxation and a consolidated basis for corporate tax would be useful as well. As for language barriers mentioned by a previous speaker, they are disappearing online with the use of translation apps.

A regulator reiterated that, before addressing such challenging issues as insolvency laws and taxation, which are essential, it is important to realise that the credibility of CMU relies on timing and on delivering first and rapidly what is already on the table.

3.2 EU-level supervision

A regulator stated that the digitalisation of financial services means that there will be more cross-border services and investment in the future, but the framework for supervising cross-border retail markets and addressing investor protection concerns in this context does not yet exist in the EU. At present, investor protection relies entirely on the home supervisor and is fragmented across 27 jurisdictions. Supervisors have different levels of competence depending on the size and activities of the financial sector in their jurisdiction. With increasing digitalisation, firms might locate in countries with a lower level of sophistication in terms of capital market supervision and distribute their products throughout the EU. Moreover large jurisdictions will increasingly be host supervisors with a difficulty to appropriately address customer protection issues in their jurisdiction posed by firms and products based in other EU countries.

The regulator suggested that after having delivered the proposals of the current CMU action plan, a review of the supervisory framework is needed to support the development of cross-border investment, which is one of the objectives of CMU. An option, considering the way the Single Supervisory Mechanism (SSM) for banking activities is structured, could be to have a different supervisory approach for entities that are above a certain size and are truly cross-border.

4. Way forward

The Chair suggested that a timeframe is needed, together with a political agreement to deliver the planned initiatives of the CMU sufficiently fast i.e. in this European cycle and before the next parliamentary elections.

A policy-maker summarised that the comments made by the panellists essentially go in two directions: the need to deliver quickly and the suggestion to do more on CMU. These two objectives are valid but contradictory to a certain extent because the more that is done and the more ambitious is the action plan, the harder it is to deliver quickly. Best efforts are being made by the Commission to find the right balance between these two conflicting objectives. Reacting to some suggestions made by the panellists, the policy maker agreed that further work on securitisation could be beneficial, but there is resistance of some stakeholders towards this. Concerning SMEs, a Listing Act is in progress, however, the more that is put in that, the harder it will be to deliver quickly. The priority is first to deliver the initiatives that are on the table as fast as possible. Strong political support is essential for moving the CMU forward, but it must go beyond commitments in principle and materialize in compromises on the legislative texts proposed.

An official agreed that there is a trade-off between ambition and speed and that many good proposals have been made. The difficulty in making progress is that there are many divisions not only within the Council but also among market players. The Council is split on securitisation for example between those who want a more competitive banking market and those who favour customer protection and regulatory stability. It is the same for market participants about the importance of the consolidated tape and how to implement it. There are also different views about reinforcing EU level supervision through ESMA. This latter issue is further complicated by the fact that within the EU some countries have developed capital markets that require sophisticated supervision and others have practically no capital markets and limited supervision functions in this area. In any case, creating a true, functional European supervisor raises many challenges in terms of resources and budget, which are difficult to tackle in the short term.

An industry representative stated that they would encourage the Commission to take a 'minimum viable product approach'[3] to the CMU next steps in order to put sufficient conditions in place to move as fast as possible. The digital space must not be forgotten in the CMU debate. Otherwise, the 27 countries will impose their own rules, and this will result in a new layer of dis-harmonisation on top of the existing one. In order to create more support for the CMU among political decision makers and the wider public, the industry speaker suggested that consideration could be given to renaming CMU with a view to putting savers and the financing of the economy, notably SMEs, at the centre of it.

A second industry representative stated that regulators face a difficult task. However, the contrast between either working on a large scope of proposals slowly or a smaller scope quickly is too restrictive. Another option is adopting a more iterative approach to regulation, rather than the current sequential approach. MiCA for example includes asset reference tokens in the definitions of crypto-assets, derived from the Libra concept, which is now dead. If legislation was developed iteratively, starting with a broad framework and then adjusting and refining the detail, a great deal of speed could be gained.

A third industry representative reiterated that there are two priorities for the CMU, SMEs and retail, where focus at the EU level should be increased. If retail investors get used to investing in SMEs, SMEs will see the benefit of accessing capital at the stock exchanges and will know that they can rely on this source of funding. Investors will get better returns than on their savings accounts and play an active role in developing economic growth and job creation. Achieving this combination should be the main priority of the CMU.

The Chair concluded that while CMU has to be democratically negotiated, the CMU project cannot be delayed indefinitely while agreement is found on all topics. At some point there must be a priority given to achieving progress on the building up of a European capital market over the detail of the substance.

3. The MVP approach is based on the premise that sufficient customer value can be provided by delivering minimal features that early adopters will use. Feedback can then be collected and used to build a better product that will resonate with future users.