CMU: WHAT CAN BE DONE IN THIS POLITICAL CYCLE?

VERENA ROSS
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Making headway on centrepieces of the CMU

Recent challenges to the geopolitical and economic landscape have reinforced the need to develop a genuine single market for capital in the EU. This is necessary not only to boost resilience to economic shocks, but also to stimulate sound and sustainable growth for the future. Improving access to a diverse range of funding and investment possibilities and improving the overall attractiveness of EU capital markets remains an urgent priority. Therefore, supporting the development of the capital markets union (CMU) remains at heart of ESMA's mission.

The CMU package proposed in 2021 represents an important step in bringing forward some key actions to better integrate EU capital markets. The four legislative initiatives aim to improve availability of and access to company and trading data for investors, as well as increasing the attractiveness of certain investment funds.

With these proposals now in the hands of co-legislators, we wait to see the outcome of the political negotiations. Strong ambition remains necessary to progress on the CMU project which has only grown in importance over the years, and also remains a fundamental part of the digital and green transitions.

One clear signal from the November 2021 CMU package is that data and transparency are a cornerstone of smooth capital market functioning. There has been a clear and pressing case for increased transparency in building the CMU, and both the European Single Access Point (ESAP) and consolidated tape proposals aim to deliver on that.

ESAP, offering financial and sustainability-related information on companies and investment products, as well as the consolidated tape, offering real-time trading data on shares, bonds and derivatives, are necessary and welcome steps to strengthen the CMU infrastructure and facilitate flows of information to investors. Both measures will open up new sources of EU-wide data to investors, particularly retail investors, thereby facilitating better investment decision making and broadening sources of financing for companies.

While the proposals provide for some challenging new responsibilities for ESMA, we welcome the central roles that have been envisaged for us in a) building and operating the ESAP and b) selecting, authorising and supervising the consolidated tape. We are committed to function as a European datahub and to further streamlining of data reporting and collection burdens.

The outstanding, critical piece of the CMU Action Plan is the Retail Investment Strategy. Investors' trust is an essential condition for their participation in capital markets and to build such trust, transparency is key. In our advice to the European Commission, we therefore recommended several measures in this respect ranging from addressing the overload and complexity of information investors face to the effective use of online engagement (while combatting misleading marketing campaigns on social media). On the sustainability front, addressing greenwashing and tackling mis-selling rank high on our agenda to keep our investor protection framework up to speed with the rising sustainability ambitions of investors.

Overall, we must bear in mind that high-quality supervision underpins effective progress in building the CMU. It will foster more market integration while creating new opportunities for market participants and investors to exploit the benefits of the EU capital markets. The EU supervisory model needs to provide for an adequate level of consistency in supervision and enforcement within a harmonised regulatory framework. This is why we at ESMA retain supervisory convergence amongst national authorities at the heart of our mandate, but also continue to strengthen our direct supervisory efforts. Wherever supervision is undertaken, whether at EU or national level, we continue to work closely with national authorities – to foster a common EU supervisory culture and build shared principles of risk-based, data-driven and outcome-focused supervision.

As the CMU continues to evolve, so will ESMA. In the near term, we are excited to play a key role in both the ESAP and consolidated tape initiatives, as we are firm believers that more transparency will help to unlock the potential of EU financial markets. It is an essential ingredient to help sustainable growth, to the benefit of companies, citizens and the society as a whole.

With more CMU legislative initiatives expected later this year, we remain enthusiastic in our support for a genuine European and effective capital market and will do all we can to contribute to its continued construction and strengthening.

KRISTINE BRADEN

Europe Cluster Head, Citi & Chief Executive Officer, Citigroup Global Markets Europe (CGME)

Optimising policy making and minimising policy contradictions

Two and a half years after Brexit, there is uncertainty over whether or when EU and UK policy making will take different paths. Both the EU and the UK look to boost their markets and to further improve their respective regulatory regimes. To achieve this goal, they will need to balance considerations of market access and competitiveness while safeguarding financial stability. The COVID-19 pandemic, the war in Ukraine and surging inflation have required significant political focus. It is important to balance these considerations, keep them in focus and not underestimate the impact of fragmentation or inadvertent protectionism in policy and regulatory choices.

In Europe, the concept of open strategic autonomy has emerged as a driving force behind European politics and is now being translated into specific policy proposals. Adopted as the leitmotif of President von der Leyen's 'geopolitical' European Commission, it refers to the EU's capacity to pursue its interests without too heavily relying on foreign states. In today's uncertain world this is an understandable position. Furthermore, the pandemic has demonstrated the fragility of the world economic order, with its reliance on global supply chains. By near-shoring production, diversifying access to key materials, or investing in a strong digital or financial services capacity, Europe seeks to reinforce its position on the world stage while strengthening its economy.

However, for a strong Europe, global trade and access to financial services will remain a key driver of economic growth. By enabling the expansion of Italian or French corporates or helping foreign companies operate in Europe, global banks like Citi contribute to Europe's success story. Cross-border market access and market efficiency are crucial elements of global trade and prosperous economies. It is therefore important that the current negotiations on Europe's banking rules acknowledge, and do not unduly disrupt, the vital role that banks like Citi play. For instance, in providing lending and investment banking services, cross border payments as well as access to deep liquidity in a host of foreign currencies to European companies. Furthermore, as EU firms are major users of clearing houses in Europe, the UK and internationally, the upcoming EMIR review should leave clearing participants free to choose where to clear, based on commercial and risk considerations.

Naturally, market access should be based on mutual respect for rules and regulations. Regulatory standards, implemented regionally or nationally, and enforced by strong cross-border supervision are crucial elements of our international system. The strong cross-border supervisory system incorporated in EMIR 2.2 is an excellent example of this. Similarly, in sustainable finance, the EU has taken a pioneering role in setting the most ambitious disclosure and classification regulations. However, the EU should also strive for international harmonization of sustainability standards, reducing frictions for market participants and increasing overall transparency.

Within a global rules-based system, there should be ample opportunity for competition. The EU and its trading partners each strive to offer the best infrastructure and regulatory environment to attract commerce, create financial capacity and thereby grow their economies. A good example is the European Commission's review of MiFID and MiFIR, which in response to feedback from market participants aims at striking the right balance between the need for market transparency and financial sector firms' cost-efficient service provision to European clients. Europe should aim to hold to the same set of regulatory principles and only calibrate them if there is a legitimate need to do so.

An open Europe with a level playing field for market participants should be our collective ambition.

Recognizing Europe's aspirations, Citi calls for a truly 'open strategic autonomy' that provides a level playing field for market participants. Unless it is open, strategic autonomy risks creating a policy contradiction, where the drive for inward investment and the efficient supply of cross-border services bumps into protectionism. We risk creating duplicative structures making service provision by European and Third Country financial institutions unduly onerous. The ongoing crisis in Ukraine underlines the importance of like-minded partners working closely together to secure European interests and values.

A strong autonomous Europe which promotes foreign investment facilitated by a vibrant banking sector with close trading ties to the rest of the world should be our collective objective. Global standards set by international partners who share mutual interests, supported by a robust regulatory dialogue, will provide the backbone for a financial services sector that supports Europe's growth. Let's move forward – together.

BJØRN SIBBERN
President European Markets - Nasdaq

CMU – a North star for the long-term

If Europe manages to stay on the CMU path, our chances to truly deliver a stronger European capital market will remain strong.

One of the core strengths of the European capital market is the retail investor engagement. In Nasdaq's European markets, particularly Sweden, retail investors play an absolutely key role in providing financing and growth opportunities for companies, especially for SMEs. On the Nasdaq First North Growth Market, retail investors provide up to 50% of investments as well as trading volumes. Retail investors are stable shareholders that induce long-term sustainable capital. This contributes to favorable conditions for IPOs in the primary market as well as for a company's onwards life on the secondary markets.

I support the European Commission's retail agenda, but seeing how retail investor activity is very much influenced by national policies, member state initiatives are crucial, such as on financial education, pension systems and Investment Savings Accounts, especially when they mean a flat tax for investments and also automatic tax reporting, which significantly reduces administrative barriers for individuals. Over 3 million Swedes have such an account. In Finland the introduction is more recent, and numbers are increasing with currently over 225,000 accounts. In Estonia the number of retail investors on the exchange quadrupled in 5 years and is now up to 100,000.

The high retail participation on the lit and multilateral exchanges means good execution quality. In the Nordics, more than half of retail orders are traded in the spread between the best bid and ask. Against this background I see no need for dark execution for retail orders and am worried about payment for order flow. If it would be widely introduced and accepted in Europe, there is a risk that retail volume may be shifted away from the lit and multilateral markets, for no real benefit.

On the contrary, retail investors are needed where IPOs happen, where share prices are formed, and where they benefit from non-discretionary execution.

All investors, including retail, need access to data to be active on the markets. Currently Nasdaq's equity data is available for free after 15 minutes and real time data on best bid and ask at cost, which to retail investors we offer for 1€ per month. What investors lack is a picture of the non-exchange market. A consolidated tape in EU could provide this by covering equity data from all exchanges, MTFs and Systematic Internalizers. What is important to note is that Europe's geography has natural built-in latency. For a tape in EU to provide a true picture of all transactions equally and fairly for all users, it needs to have some delays.

From my experiences of market data, the highest demand for the fastest data comes from bigger and very sophisticated professional market participants and concern blue chip shares. Having exchanges bear the cost of a close to real time tape would hence tend to mostly benefit the bigger and professional market participants to the detriment of transparent markets. However, for smaller players such as retail investors, SMEs and smaller venues, a delayed tape is the product that would deliver benefits compared to costs. This is an example of when keeping the CMU as a North Star is important.

Stay on the CMU path, our chances to truly deliver a stronger European capital market.

An initiative that better keeps to the spirit of the CMU is the Listing Act initiative. Parts of this initiative that I support are clarifications in the Market Abuse framework which should leave less room for diverging interpretations and sanctions. Furthermore, simpler prospectuses can be helpful documents instead of obstacles for both issuers and investors. I also insist that each issuer should be given the power to decide when translation costs for disclosure documents add value, and English only should always be allowed, as it is the prominent language within finance today. A European Single Access Point will not add value unless investors from outside the local can actually use it.

Letting CMU be the North Star across policy areas for the long term would increase the opportunities of further improving the European capital market and help Europe to strengthen its competitiveness in the global economy.

Supporting stability and growth opportunities for individuals as well as corporates is what is needed to manage through the current times of many levels of uncertainty and crises.

BJÖRN STORIM
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How to deliver a European Capital Markets Union – The European perspective

The Capital Markets Union (CMU) project has a problem.

The fundamental challenge, and until now the fundamental failure of the project, is the need to build a political connection between the high-level narrative explaining why a CMU is desirable and necessary, and the individual policy measures that are needed to deliver a CMU.

The high-level narrative explaining why a CMU is desirable and necessary has been set out many times. Capital markets are a mechanism that can transform savings into long-term investment. Capital market financing offers increased resilience, flexibility and choice to savers and investors and to the economy as a whole. At a time when there are great needs for long-term investment – to deal, for example, with the climate emergency and to finance infrastructure investments – capital markets offer the possibility to finance additional investments.

Capital markets are eco-systems. Developing a European capital market eco-system, especially given the weak and under-developed state of many European capital markets, will not be achieved by just one or two individual policy measures. There is a need for a broad and diverse range of policy measures.

But we run into the problem that in many cases each individual CMU policy measure is viewed in isolation, and the costs and benefits associated with that policy measure are viewed from the perspective of current individually segmented national capital markets.

Taken in isolation, and from a national perspective, many individual CMU policy measures involve cost and risk, and may deliver few immediate obvious concrete benefits.

But if we look at these measures from a European perspective, the story is very different.

From a European perspective, it is grotesque and counter-productive that investors, both European and non-European, buying European securities are forced to manage 27 separate and different national withholding tax procedures. Dealing with this issue, and building a common pan-European operational process, should be an absolute priority. It would be absurd that we can build a pan-European operational process for late settlement penalties, a relatively minor issue, and not manage to build such a process for a major issue such as withholding tax.

From a European perspective, the lack of a depositary bank passport is a similar absurdity. The current obligation placed on investment funds to use depositary banks from the same member state is a prime example of a measure that segments national capital markets, that handicaps depositary banks in Europe, and that reduces choice for investment funds and for investors in those funds. The lack of a depositary bank passport is a clear gap in the Single Market.

A European perspective should cover not just the questions of how to develop individual capital markets and how to break down barriers between individual markets; it should also cover the question of what core features are necessary to create common pan-European markets.

The creation and development of common pan-European markets require that all market participants, no matter where in Europe they are located, have access to the same core rights, to the same ability to issue, invest in, and hold, securities, and to the same core information.

But if we look at these measures from a European perspective, the story is very different.

One important question is to what common core reference data do market participants and all parties in the custody chain (issuer agents, CSDs, and intermediaries) need to have access, in order for markets and the custody chain to work fairly, efficiently and effectively.

This question highlights the need to build and deliver both a consolidated tape and a European Single Access Point (ESAP), but also draws attention to some of the weaknesses of the current ESAP proposal. ESAP today is very much an incremental and reactive proposal, building on existing data, rather than a proposal that is based on an analysis of the underlying needs for core data.

The European perspective is valuable not simply because it tells us which policy measures are important to deliver a CMU, but also because it holds the key to creating awareness that the rationale, and high-level political narrative, for a CMU, apply just as much, and much more concretely, to individual CMU policy measures.

FABRIZIO CAMPELLI

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EU needs progress on the Capital Markets Union to deal with future challenges

European capital markets will face extraordinary challenges over the next years, and we must accelerate measures to address them.

The CMU was originally conceived in 2015 to ensure borderless capital flows in the EU. While some progress, such as for cross-border venture capital investments, has been made, overall success has been limited. The EU capital market is still smaller than its counterparts in the US and APAC relative to GDP and comprises 27 capital markets with different maturities and regulatory frameworks. Moreover, due to Brexit, not only has the EU lost around a third of its capital market, but it has gained a competitor with high liquidity.

Whilst the latest iteration of the CMU action plan from 2020 tries to address some shortcomings of the project, the need for a functioning CMU has increased significantly. We are entering a phase of economic and geopolitical uncertainty triggered both by the longer-term impacts of Covid and the direct and indirect consequences of the war in Ukraine.

In addition to facing the extraordinary task of funding the transition to a green and digital economy, Europe now also needs to accelerate this transition to reduce its energy dependence, increase commodity security and diversify its global supply chains. McKinsey estimated in 2020 that reaching net-zero would require an estimated €28 trillion investment in clean technologies over the next 30 years (about €5 trillion of this would be additional investment, while €23 trillion would come from redirecting investments that would otherwise have funded carbon-intensive technologies).

The source of funding for all of this remains unclear. On the public side, Covid support packages have depleted public finances and rising costs for lending will further limit funding capacity, while there is at the same time also the need for significantly increased defence spending. On the private side, banks will be unable to provide financing on their own, not least because they are constrained by regulatory headwinds such as contributions to the EU single resolution fund, (national) macro-prudential buffers and potential impacts from Basel III implementation.

All this means that there is an accelerated need to finally get things moving for a CMU. Given the challenges we face, we need to readjust and recalibrate the priorities of the CMU to focus on the most impactful measures to finance Europe's economic transformation.

To achieve these goals, we need 3 focus areas:

1) European capital markets need to be globally competitive

The regulatory framework in which European firms operate in must provide a level playing field with global competitors to access global liquidity pools. There are a number of areas to address: (i) the extraterritorial application of the regulatory framework limits EU banks in their ability to compete for international clients and investments - greater deference to international standards is needed to adjust for this, (ii) proposed measures to foster strategic autonomy, such as in clearing could result in penalising European banks and drive business outside the EU and (iii) the European regulatory framework is not flexible enough to react to changing market environments - more agility in decision-making processes is needed to prepare it for future challenges.

There is a need for recalibration of the CMU to fund a diverse set of challenges.

2) Capital market funding needs to be increased

To diversify away from the dependency on banks for funding we need to address the EU securitisation framework. The current rules with punitive capital treatment for banks and insurers are overly onerous. Progress needs to be made quickly - a lot of time has been lost with the current regime. Also, trust of investors in capital markets need to be strengthened and retail investors need the opportunity to invest into a broader range of financial instruments, with levels of investor protection commensurate with their knowledge and experience.

3) Greater harmonisation of national regulatory frameworks

The EU capital markets framework is still deeply rooted in national provisions which have developed over decades and hampers cross-border provisioning of services. A greater harmonisation of these frameworks combined with the completion of the Banking Union would facilitate cross-border bank mergers.

Only if we focus on putting these measures into practice quickly, will the CMU project be a success in providing the funding needs to the EU economy.