Capital Markets Union: progress made and future steps

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1. Objectives of the Capital Markets Union (CMU) initiative

The Capital Markets Union (CMU) initiative was launched in 2015 with the objective of developing and further integrating capital markets in the EU in order to (i) diversify the financing of EU enterprises, particularly the most innovative and fastest growing ones and (ii) provide savers with improved long-term investment opportunities, while better connecting savings to productive investment across the Union. At the macro-level, the CMU also aims to preserve financial stability and enhance the resilience of the EU economy by fostering a geographical diversification of funding sources, strengthening private risk sharing across the EU and reducing the reliance on bank financing, which has in the past led to an excessive concentration of risks on bank balance sheets.

The importance of channelling savings towards the EU capital markets for Europe's continued prosperity and strategic sovereignty has recently been re-emphasized in an op'ed article published by the Presidents of the European Council, European Commission, Eurogroup, ECB and EIB[1] who also stated that bank financing and public investment will not be insufficient to provide the investments needed for the green transition, boosting technological competitiveness and diversifying supply chains[2].

Capital markets are indeed essential to fund fast-growing and innovative businesses due to their capacity to finance immaterial assets and projects with a long term perspective and disperse risk across a wide range of investors, thus completing the financing provided by banks. In addition studies have found that capital markets may reallocate funds towards less-polluting sectors more efficiently than more traditional financial activities and provide stronger incentives for carbon-intensive sectors to develop greener technologies[3].

The importance of the CMU together with the Banking Union for enhancing the open strategic autonomy[4] of the EU and strengthening confidence in the euro has also been stressed in the Communication on CMU published by the Commission in November 2021. Developing deep and liquid capital markets within the Union and enhancing the attractiveness of European capital markets to domestic and foreign investors is also important in a post-Brexit context, where frictions with the UK are due to increase.

2. Capital markets remain under-developed and fragmented in the EU

2.1 The size of capital markets relative to GDP is lower in the EU27 than in the US and UK

It is a well-known fact that EU capital markets as a whole remain quite under-developed compared to those of other major economies such as the US or the UK when considering their size relative to GDP. Although structural differences (*e.g.* in the pension systems between the EU and US and in the way capital markets and banks have evolved historically in each region) mean that the US cannot be considered as a direct benchmark for the EU, the comparison with the US shows that the development potential of EU capital markets is still significant, particularly in the retail space and for the financing of SMEs[5].

At the end of 2021, EU securities markets where about half the size of those in the US in percentage of GDP and also smaller than those of major economies such as Japan, China and the UK. The total of EU27 debt securities and public equity markets represented 233% of GDP compared to 449% for the US, with the main difference coming from public equity markets which amounted to 81% of GDP in the EU compared

1. See "Channeling Europe's savings into growth" – Op'ed article – 9 March 2023.
2. In addition, the op'ed article stresses that the role of public investment is mainly to incentivise a crowding-in of private investment and give policy directions, rather than provide the bulk of the financing.
3. Source: Bruegel "Europe should not neglect its Capital Markets Union" June 2021.
4. The concept of open strategic autonomy, meaning in effect non-dependence on foreign jurisdictions or players, has progressively expanded from the security and defense dimension to many other areas, such as energy, healthcare and, with the UK exiting the EU, to the financial services.
5. Measured by criteria such as the availability of retail pools of capital for investment in capital markets, the access of non-financial companies (NFCs) to capital…, which are significantly lower than the US (*see 2.3*).

to 227% in the US. In addition while public equity markets significantly grew in the US between 2015 and 2021 (from 137% of GDP to 227%), this was much less the case in the EU27 (81% compared to 61%)[6].

The smaller size of EU capital markets is in part due to their lower liquidity and competitiveness (*see 2.3*)[7]. Other key differences with the US are the more limited amounts of venture capital (VC) and private equity (PE) funding invested in the EU and also the lower number of IPOs, which lead to a reduced availability of capital for innovative and growing companies[8]. For example, the biggest EU VC firm was 3 times smaller than the 10th US VC firm by money raised over the last decade (2010-2019)[9].

These average EU figures also mask strong contrasts between different parts of the Union. Indeed the size of capital markets relative to GDP is quite high in the Nordic countries (around 360% in 2021), with a balanced proportion between public equity and debt securities markets. In a second group of Western European countries including France, Germany, the NL, Belgium, capital markets are smaller but still around 250% of GDP (albeit with a higher proportion of debt vs equity relative to GDP than in the first group).

Thus, although there is a margin of progression in the whole of Europe, the deficit in capital market financing is mainly concentrated in Southern European countries, with the exception of Spain, and in Central and Eastern Europe (CEE). Capital markets represent respectively 208% and 82% of GDP in these two regions and equity markets are practically inexistent in the CEE region and quite limited in Southern EU countries. In addition, the size of capital markets remained stable in CEE and Southern European countries relative to GDP over these last few years, whereas they progressed in the rest of Europe.

Another difference between the EU and the US in terms of capital markets is the much more limited size of securitisation issuance in Europe. The EU market grew to 800 Bio € in 2008, but has since constantly decreased to reach 230 Bio € at the end of 2021 despite the introduction of a reviewed framework, whereas the US market significantly grew during the same period from around 1 Tio € in 2008 to more than 3 Tio in 2021.

2.2 Capital market funding and investment remain limited in a large part of the EU

At the micro level, the structures of EU household financial assets and business funding confirm the under-development of EU capital market sources of finance.

During the 2015-2020 period, on average, EU households held 32% of their financial assets in securities directly or via investment funds compared to 51% in the US, according to figures from a recent CEPS study[10], to which should be added part of the 33% of financial assets held via insurance products and pension funds[11]. In total it can be estimated that around 55% of financial assets are held directly or indirectly in securities in the EU by households compared to more than 70% in the US[12]. The proportion of financial assets held in currency and bank deposits is also significantly higher in the EU (31%) than in the US (12%). In addition, while EU household capital market savings grew during the pandemic, they have decreased in 2022, practically going back to pre-pandemic levels (around 104% of GDP) according to recent AFME figures[13], as economic uncertainty has increased.

The situation in terms of retail investment moreover varies to a large extent across EU member states. In the Nordics and NL, securities and pension fund based assets are the largest categories of financial assets. Currency and deposits in these countries represent less than 20% of financial assets, a little over the US proportion of 12%. Whereas in many Southern European and CEE countries, bank deposits and savings accounts represent between 35 and 50% of household financial assets. The CMU indicators also show significant variations across member states in terms of % of financial assets invested in securities via investment funds and insurance products (15 to 80%)[14].

As for non-financial companies (NFCs), although it is difficult to have a fully clear and up-to-date

6. Figures from 2020 show that the EU-27 average stock market capitalisation amounted to 52% of GDP in EU-27 in 2020, compared to 116% in the UK and more than 190% in the US. In 2019 % were similar for the EU and UK, but were closer to 150% for the US.- Source World Bank database. Capitalisation represented by the outstanding listed shares issued by domestic firms.
7. The lower perceived attractiveness of the underlying firms and economies in terms of investment return also play a role.
8. Source CEPS "Time to re-energize the EU's capital markets" Nov 2022.
9. Source Banque de France "CMU: unleashing Europe's potential" Speech by F. Villeroy de Galhau Nov 30th 2021.
10. Source CEPS "Time to re-energize the EU's capital markets" Nov 2022.
11. When considering the breakdown of assets held in pension products, it appears that in the US the proportion of pension fund assets held in equity and mutual funds is higher than in most EU countries: nearly 60% of assets in the US compared to an average of 20 to 40% in the EU, the remaining part being held in bonds (20%), short term debt and real estate. Source Eurofi Regulatory Update February 2022 – Retail investment: opportunities, challenges and policy proposals.
12. This proportion is in line with the CMU indicator of 'intermediated retail investment by households' published by the Commission, which shows that around 58% of households' financial assets were held directly or indirectly in securities in 2020 in EU.
13. Source AFME CMU Key Performance Indicators 5th edition November 2022.
14. Source: CMU indicators – European Commission July 2022 – Indicator 21 Intermediated retail investment by households measuring the Sum of volumes of investment funds and claims against insurance and pension funds held by households relative to the sum of volumes of both and cash holdings and deposits.

picture of their funding situation compared to other jurisdictions from current studies, the available data shows that the capital market funding of NFCs in the EU is significantly lower than in the US and UK. An IMF report from 2019 evaluates the share of listed securities at 28% of the funding structure of EU NFCs[15] compared to 47% in the UK and 69% in the US[16]. Loans (bank and non-bank loans) represent around 35% of the financing of NFCs in the EU, according to the IMF report, compared to 20% in the US[17]. Another report from the OECD also shows that debt securities amounted to 12% of NFC debt financing in the Euro area in 2019 (the rest being loans) whereas this share is of 65% in the US. A further indicator is the share of the EU in the global equity market capitalisation of listed shares which accounted for 10% of the world's total in 2022, down from 18% in 2000[18] and below its share of the world GDP (16%).

This relatively low level of capital market funding of NFCs in the EU is due to a combination of supply and demand factors including the complexity and cost of listing, the current taxation bias in favour of debt and also the lack of appetite of entrepreneurs for listing due to the potential impacts on the governance of their firm. Indeed while it is estimated that the equity funding gap in Europe among NFCs amounts to € 300-600 billion[19], the CMU indicators published by the EU Commission in July 2022 show that on average only 11% of SMEs consider that equity funding is relevant for them, with a few exceptions such as Sweden, where this figure reaches 50%. In addition there are practically no SMEs declaring that they need equity and that equity is not accessible to them in 2021, except in a certain number of CEE countries[20].

Capital market funding is moreover impacted by the underlying economic situation and the volatility of markets. AFME statistics show that the funding of NFCs derived from capital market sources grew to 14.1% in 2021 from 11.3% in 2019[21], but has decreased in H1 2022 to 9.4% with the lowest share since 2012. The increase in 2021 is due in part to a higher number of IPOs and greater PE / VC investments in 2021[22], which have now tended to decrease due to higher economic uncertainty and market volatility.

In conclusion, while EU capital markets are generally under-sized compared to some other world economies relative to GDP, the situation differs significantly across the EU with two main groups of countries: the Northern and Western European countries[23] that represent around 60% of the EU's GDP, where capital markets are relatively developed and continue to grow, and the CEE and most of the Southern European countries where they are significantly under-developed or practically non-existent and tend to stagnate.

2.3 EU capital markets are still fragmented, despite harmonised regulation, limiting their liquidity and depth

In addition, there is a persistent fragmentation of EU capital markets, despite the efforts made to harmonize rules and integrate markets with the implementation of EU securities legislations such as MiFID, EMIR and CSDR, and TARGET2Securities harmonisation efforts[24]. This fragmentation reduces the liquidity and depth of EU capital markets and leads to differences in the cost of capital and access to capital market instruments across the Union. Combined with the under-development of capital markets in the EU, fragmentation raises financing costs for issuers and reduces the cost-efficiency of risk and capital allocation for market participants, as well as potential long term return for investors, in comparison to other markets at the global level.

A first indicator of fragmentation is the high level of home bias in equity and debt detention in the EU. Figures from the July 2022 CMU indicators published by the Commission show a home bias[25] – *i.e.* a detention of domestic assets – of 85% at EU level for equities (down from 90% in 2015) and 69% for debt (stable). For equities, the home bias ranges between 75% and 95% across member states but is more variable for debt (from 30 to 95%).

15. To which should be added around 35% of unlisted securities compared to about 15% in the US.
16. Source IMF staff discussion note "A Capital Market Union for Europe" September 2019.
17. The market funding ratio of the European Commission CMI indicators (July 2022) – indicator 1 – evaluates that around 50% of NFC funding comes from corporate bonds and listed shares in 2020 with significant divergence across member states (10 to 60%). This indicator focuses on listed shares and corporate bonds relative to bank loans, leaving out non-listed shares and non-bank loans.
18. Source AFME CMU KPI 2022.
19. See Eurofi Financial Forum Prague Summary September 2022 – Listing Act and DEBRA: prospects for equity markets.
20. Source: CMU indicators – European Commission July 2022 Indicators 13 SME use of equity and indicator 14 SME equity financing gap.
21. AFME CMU KPI 5th edition November 2022. This indicator quantifies the proportion of total finance for NFCs which is provided by equity and bond issuance as a percentage of the total funding received by NFCs (*i.e.* new loans plus equity and bond issuance).
22. An increase of equity holdings by insurers was also observed during that period.
23. the Nordics, France, Germany, NL, Belgium, Spain.
24. See Eurofi Summary High Level Seminar 2021 Lisbon. The ECB's high-level indicators suggest that in quantitative terms the increase of cross-border transactions in the EU has not been significant over the last few years. T2S cross-CSD settlement data as a proxy seems to be stagnating at around 3% of T2S's total turnover recently. Data on CSD links shows a similar picture to general ECB security settlements. Holdings via CSD links seem stable at around 21% of securities outstanding with no increase since the Central Securities Depositories Regulation's (CSDR) introduction or the T2S go-live. When looking at the cross-border issuance of securities, quantitative data from the eligible asset database suggests that securities' cross-border issuance across national CSDs is stable at relatively low absolute levels.
25. The home bias indicator included in the CMU indicator toolkit represents the share of domestic investment relative to the EU investment *i.e.* the difference between the actual and the optimal share of foreign equity in EU investors' portfolios under assumption of perfect integration.

A second indicator is the cross-border distribution of investment funds. Although the number of UCITS available for sale to retail investors in at least 2 member states is increasing in the EU[26], a report of February 2022 from the European Court of Auditors (ECA)[27] on the investment fund single market showed that funds are mainly distributed in their domestic market, even if they are registered as cross-border. Nearly 70% of funds held in the EU continue to be focused on domestic markets and are sold by domestic asset managers. Part of these are "round-trip" funds which are notified for cross-border marketing but are only sold domestically, making the actual cross-border marketing of funds more limited that notification figures may suggest.

A third indicator is the fragmentation across national lines of the EU trading and post-trading infrastructure. The EU counts 27 national stock exchanges plus some regional exchanges, 17 CCPs and more than 30 CSDs compared to 2 to 5 main players of each category in the US, and although some consolidation is driven by the main trading and post-trading infrastructure groups in the EU, the underlying markets remain separate to a large extent with differing rules, order books, etc. This having been said the 4 main exchanges (Nasdaq Stockholm, Deutsche Börse, Euronext Paris and Amsterdam) represented nearly 70% of EU market capitalisation and more than 60% of the capital raised through IPOs in 2021, showing a significant level of concentration of European markets in some key financial centres. The clearing market particularly for government debt and derivatives is also relatively concentrated in a few CCPs.

As part of its CMU KPIs AFME[28] also monitors the level of integration of EU capital markets in a holistic way taking into account different factors including the cross-border issuance and holdings of debt and equity, FX trading volumes and cross-border PE investment and M&As. This composite indicator shows that intra-EU integration of capital markets has stagnated over the last few years. The level of integration is relatively low (with cross-border volumes lower than 25%) for all criteria except the cross-border issuance of debt, which is above 90%.

2.4. The competitiveness of EU capital markets also shows significant potential for improvement

An additional element to consider is the competitiveness of the EU capital market ecosystem. This is an important factor for retaining investments in the EU and also attracting investments from outside the EU. Competitive markets indeed facilitate the cost-efficient allocation of risk and capital by market participants and reduce the cost of access to capital.

Competitiveness is driven by several elements including: the availability of local pools of capital; market liquidity[29]; and the ease of access of local NFCs to capital (public markets and PE/VC capital).

Based on these criteria and also taking into account the level of digitalisation of EU capital market ecosystems and their capacity to support new trends such as the green transition, AFME has elaborated a composite indicator that shows that the overall competitiveness of EU capital markets has slightly improved over the last few years (2018-2022), but it remains significantly lower than the US and UK. The largest gaps with the US are in terms of availability of pools of capital (notably the amount of household savings invested in capital market instruments and pension funds) and access of NFCs to capital market finance, while with the UK, the key difference is in terms of market liquidity, due in particular to the role currently played by the UK as a global hub for derivative and FX markets[30]. AFME data also suggests that EU corporate bonds are less liquid than US ones *e.g.* with less daily trades.

In terms of market liquidity, the situation appears to be generally stable in the EU over the last few years, according to the data available. While a significant part of the trading activity on EU equities, particularly on-venue, has shifted to the EU following Brexit and the implementation of the EU share trading obligation, the impact on liquidity for the overall European equity ecosystem (EU, UK, Switzerland) of these evolutions is "non-conclusive" according to AFME assessments, due to the current fragmentation of the EU trading market across venues and jurisdictions[31]. The liquidity of government bond markets has also decreased over the last few years for the main EU member states[32].

26. Source European Commission CMU indicators – July 2022 – Indicator 30: cross-border UCITS measuring the number of UCITS available for sale to retail investors in at least two member states.
27. Source ECA Report on Investment funds – EU actions have not yet created a true single market benefiting investors – February 2022.
28. Source AFME CMU Key performance indicators – Fifth edition – November 2022.
29. Liquidity refers to the efficiency or ease with which a security can be converted into ready cash without affecting its market price. One first dimension of liquidity is market depth. A market is deemed deep if there is a large flow of trades on a frequent basis with a persistent willingness to trade by market participants. A second dimension is market breadth *i.e.* the consistency with which liquidity is distributed within asset classes. A third element is tightness *i.e.* bid-ask spreads, measuring the difference between the price market participants are willing to pay and the price at which they are willing to sell, approximating the financial cost of completing a transaction.
30. According to the BIS the UK is the largest hub for FX and derivatives trading at the global level, intermediating 38% of global FX trading and 46% of global derivatives trading, which participates in the development of global liquidity pools in the UK.
31. Compared to the previous situation where significant equity volumes were traded in the UK, which is by definition a more integrated market.
32. Possibly due in part to the accommodative monetary policy used over the last few years.

For corporate bonds it is more difficult to conclude, but trading appears to be concentrated in a relatively small amount of bonds and on the first days of trading after issuance.

The CMU indicators of the European Commission confirm the stability of most liquidity indicators (market breadth, bid-ask spreads...), except for the market breadth of SME shares, which grew in 2021 probably thanks to an increase of the number of IPOs.

AFME also evaluated, as part of its CMU KPIs, the integration of EU capital markets with the rest of the world (ROW), measured by the % of cross-border issuance and holdings of debt and equity, FX trading volumes and cross-border PE investment and M&As. According to this indicator, the level of integration of the EU capital markets with the ROW has remained relatively constant over the last 20 years. Most components of the EU capital market ecosystem have a level of integration with the ROW lower than 20% except for M&A activity. Integration with the ROW is also significantly lower than the UK, which is one of the most interconnected capital markets in the world, due in particular to the large flows of FX transactions and interest rate derivatives intermediated in the UK.

3. Progress made with the CMU initiative and latest proposals

3.1 Legislative and non-legislative actions implemented in the context of the CMU initiative (2015-2020)

Following the launch of the CMU initiative, two CMU action plans including legislative and non-legislative measures were adopted successively in 2015 and 2017 and are now in force, although part of the measures are only starting to apply in the market.

The initial CMU Action Plan published in September 2015 set out 33 actions including measures to relaunch securitisation, facilitate the cross-border distribution of investment funds, optimise prudential calibrations related to capital market activities, simplify prospectuses, etc.[33] Following the mid-term review of the CMU, a new set of measures was proposed by the Commission in 2017, covering additional objectives such as the strengthening of the powers of the European Supervisory Authorities (ESAs), the development of fintech, the promotion of sustainable finance, the facilitation of SME listing, the provision a new Pan European Pension Product (PEPP) framework and support for the growth of local capital markets[34].

Despite the significant enhancement of the EU capital market legislative framework that these two action plans led to, the general feeling in 2020 among market stakeholders was that much remained to be done to further develop and integrate EU capital markets and make the CMU a reality. There was also the perception that the implementation of CMU was too slow to address rising financing needs in the EU[35]. This prompted the Commission to set up a High Level Forum group (HLF) to make proposals for relaunching the CMU.

A new set of measures, presented as potential 'game-changers' for the CMU were proposed by the HLF in 4 areas: the financing of EU businesses, market infrastructure, retail investment, the internal market. These proposals have since been integrated by the Commission in the new CMU action plan published in September 2020 and endorsed by the Council, which is currently being implemented (*see 3.2.*). The HLF also suggested a stricter monitoring of the overall CMU implementation timetable, on which progress has been made with the publication and regular update by the Commission of indicators to monitor the progress of the CMU[36]. A further proposal of the HLF was to seek an upfront tripartite institutional agreement between the Commission, the Council and the Parliament on the main components of the CMU action plan proposed. This was not achieved as such, but political support for the CMU has been demonstrated since in many European Council and Euro Summit statements, as well as in the recent op'ed article published by the Presidents of the European Council, European Commission, Eurogroup, ECB and EIB[37] referred to previously in this note.

In parallel, efforts are being made to develop local capital markets, for example through the Technical Support Instrument (TSI)[38], whereby the EU provides

33. These include measures to develop securitization and covered bonds, improve Solvency II calibrations, prospectus and investment fund rules, facilitate the cross-border distribution of funds and also some non-binding measures regarding withholding tax and insolvency proceedings.

34. The actions proposed in 2017 to support the development of local capital market ecosystems included: the provision of technical support to Member States through the Technical Support Instrument (TSI) or previously the Structural Reforms Support Programme (SRSP) and the establishment of a CMU Working Group by the Vienna initiative to promote the diversification of investment finance in the region. The Commission proposed to establish a comprehensive EU strategy in 2018 on steps that could be taken at EU level to support local and regional capital market development across the EU.

35. A first reason for this perception is that EU capital markets have not significantly grown since the launch of the CMU, as shown by the figures above, except non-bank funding through debt securities and retail investment to a certain extent during the Covid-19 crisis. Secondly, there has been frustration among many market stakeholders with the protracted implementation of the two first action plans and the lowering of the initial ambitions of certain proposals such as those concerning the ESAs' operations or securitisation, showing a disconnect with the strong political commitment to CMU expressed by the Council in particular.

36. See CMU indicators – European Commission July 2022.

37. See "Channeling Europe's savings into growth" – Op'ed article – 9 March 2023.

38. Previously known as the Structural Reform Support Programme (SRSP).

technical assistance to certain EU Member States for reforms that include the development of their capital markets. Actions are also undertaken by the IFIs[39] such as EIB, EIF, EBRD to support the development of local capital markets and SME funding in particular. A report of the European Court of Auditors (ECA) however pointed out in 2020[40] that a comprehensive strategy for the development of local markets is still missing and that the European Semester is not used to its full potential to foster capital market reforms. The TSI is demand-driven and tailor-made at the request of individual Member States and therefore leads to piecemeal action, but these actions could be the basis for more coordinated initiatives at the regional or EU level aiming to grow local markets. The work undertaken in the context of the Vienna initiative on the financing of innovation is an example of a regional initiative that may further support the development of capital markets.

3.2 Objectives and legislative measures proposed in the new CMU action plan published in November 2021

The Commission published in September 2020 a new action plan for completing the Capital Markets Union (CMU) based on the recommendations of the HLF report, which is being progressively implemented (*see detail of the proposals in the Appendix*). The objective of the Commission is that these new measures should all be adopted by the end of the current legislature in 2024[41].

This new action plan has a more specific focus on developing SME financing with the proposed Listing Act aiming to simplify listing requirements for companies wanting to raise funds on public markets and with the setting up of a European Single Access Point (ESAP) to public financial and sustainability-related information on EU companies. The further engagement of retail investors is another important objective of this action plan, with the ELTIF review facilitating access of retail investors to these funds and a Retail Investment Strategy proposal due to be published before the summer of 2023. The action plan also aims to enhance the structure and transparency of EU securities markets with the review of MiFIR[42] and the functioning of the alternative investment fund market with the AIFMD review. It moreover sets out stronger ambitions than the previous action plans for EU capital market integration, addressing in particular the fragmentation of insolvency regimes, albeit in a targeted way.

There is also the objective with this new action plan of correcting some existing measures with the improvement of instruments that have not delivered all the benefits expected in the previous stages of the CMU, such as ELTIF funds, a review of insurance[43] and banking prudential requirements[44] impacting long term investment and the Listing regime completing previous measures to facilitate SME listing. Non-legislative tools are also being developed to improve pension provision and retirement savings in the EU (pension auto-enrolment, pension dashboards and best practices for the enhancement of pension systems)[45].

The Commission has moreover made proposals to strengthen EU capital market infrastructures with the review the Central Securities Depositories Regulation (CSDR) in March 2022 aiming to increase the efficiency and safety of securities settlement in the EU[46], followed by proposals to strengthen EU central clearing in the Union published in December 2022. Finally the Commission has proposed with the Debt-Equity Bias Reduction Allowance (DEBRA) a new mechanism aiming to rebalance the costs of debt and equity financing for non-financial corporations[47], in order to achieve higher equitisation levels and discourage excessive debt accumulation[48].

39. International financial institutions.
40. ECA Special report – CMU slow start towards an ambitious goal November – 2020.
41. For an update on the proposals made see for example Keynote speech by Commissioner McGuinness at AFME – 17 November 2022.
42. Proposals include the implementation of a consolidated tape, the restriction of payment for order flow and dark trading, measures targeting systematic internalisers, the improvement of transparency measures.
43. As part of the review of Solvency II, the Commission has made proposals to amend the insurance legal framework in order to further promote long-term investment by insurance companies, without harming financial stability and policy holder protection. These proposals concern notably the appropriateness of the eligibility criteria for the long-term equity asset class, the risk margin calculation, and the valuation of insurers' liabilities, with the aim of both avoiding undue pro-cyclical behaviours and better reflecting the long-term nature of the insurance business.
44. In the context of the CRR/CRD review, the Commission moreover made proposals in terms of prudential treatment for banks 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.
45. A first step was the publication in November 2021 of a report on best practices in the area of pension auto-enrolment, which is a mechanism that automatically enrolls individuals into a supplementary retirement savings scheme unless they explicitly opt-out, in order to ensure more adequate retirement income. In addition, the Commission is working on the development of pension dashboards aiming to support Member States in the improvement of their pension systems and on the identification of best practices for the implementation of individual pension tracking systems at domestic level, aiming to provide citizens with an overview of their future retirement income.
46. The CSDR review proposal aims to facilitate the cross-border provision of CSD services and improve certain requirements notably by simplifying the CSD passporting regime and improving the settlement discipline regime.
47. The proposed mechanism combines a tax allowance on new equity with a limitation of interest expense deductibility.
48. The combination of a tax allowance on new equity with a limitation of the deductibility of interest expenses to a period of 10 years also aims to limit the budgetary impact of this measure for member states' budgets. Under DEBRA, a notional interest rate allowance would be granted on new equity for a period of 10 years, based on the yearto-year increase of equity. The time dimension of the allowance approximates the average maturity of debt, striking the balance between limiting the fiscal costs of the allowance and providing some planning horizon and stability for investors. The equity allowance would be calculated with a notional interest rate based on the currencyspecific European Insurance and Occupational Pensions Authority (EIOPA) risk free rate, plus a risk premium of 1 to 1.5% for SMEs. This top-up in the risk premium approximates the difference in the EU average of financing costs between SMEs and larger firms. On the debt side, the deductibility of net interest payments (interest paid less interest received) would be limited to 85%.

However this proposal is still at a standstill following the temporary suspension of negotiations on the proposal by the Council in December 2022.

4. Questions and priorities for the future stages of the CMU

The CMU has been built as a long term initiative addressing a broad range of drivers for the development and further integration of EU capital markets in terms of supply, demand and infrastructure. A step-by-step and iterative approach has been adopted for its implementation in the continuation of efforts undertaken over the last 20 years to harmonise the European capital market regulatory framework[49].

While significant progress is being made in the improvement of the EU legislative framework applying to securities markets with the implementation of the successive CMU action plans, many stakeholders consider that the CMU is moving too slowly in the achievement of its objectives and that effective progress in the market is still limited. The slow pace of the CMU has recently been pointed out in the op'ed article published in March 2023 by the Presidents of the European Council, European Commission, Eurogroup, ECB and EIB who stated that 'Europe has been too slow for too long in building the CMU'. Many stakeholders from the financial industry and the authorities have also suggested on the occasion of panel discussions organized by Eurofi in recent years that CMU should be streamlined going forward and refocused on a more restricted number of essential areas or objectives around which a stronger dynamic may be built. Some also consider that the focus put on further harmonising and integrating capital markets inferred by the concept of building a 'union' and recently reaffirmed in the op'ed article[50] is misguided to a certain extent, because according to them the main problem of EU capital markets is their small size and lack of depth and liquidity and not their level of integration which has progressed, notably thanks to common regulation[51].

Identifying the key priorities to focus on in the short and longer term to develop EU capital markets remains challenging however, given the breadth of potential issues to address and the magnitude of the gap in terms of capital market finance compared to other jurisdictions, particularly in certain parts of the EU.

Some stakeholders suggest that the further development of wholesale markets should be given the priority in Europe because it is those markets that drive the growth and liquidity of capital markets, from which retail customers may eventually benefit and because EU wholesale markets are already much more integrated than retail ones. The importance of enhancing the competitiveness of EU capital markets and their attractiveness to EU and non-EU investors and of fully connecting EU markets to the global ecosystem[52] and to international capital pools is also often emphasized in this context in order to increase trading and investment volumes in the EU[53]. This would involve in particular prioritizing the further harmonization of legal and fiscal rules, the rationalisation of market structure and data provision and the further unification of supervision at the EU level.

Others argue that the development of EU capital markets should focus first on key economic priorities of the Union, such as the funding of SMEs and the growth of retail investment, which would eventually contribute to the well-functioning and liquidity of the overall market including wholesale markets (*e.g.* through retail investments in pension funds or insurance-based products)[54]. The importance of sustainable investment for driving capital markets is also frequently pointed out, as well as the need to develop private pensions with the ageing of the population[55].

A further idea regularly expressed is that capital markets cannot be developed in isolation in the EU, due to the current importance of bank financing, and that there is a need to build synergies and complementarities between the different components of finance (*i.e.* capital markets, banking, insurance, pension funds etc. and also public funding). This means understanding how each type of financing

49. These initiatives include the Financial Services Action Plan action plan for a single financial market (FSAP) in particular which put forward measures for establishing a single market in wholesale financial services, making retail markets open and secure and strengthening the rules on prudential supervision, which was followed by the implementation of key EU capital market frameworks such as MiFID, EMIR, CSDR and also the AIFMD directive and ELTIF regulation, the reviews of which are mostly incorporated in the current CMU initiative.

50. See op'ed article 9 March 2023. "The EU has already taken some decisive steps in creating a Single Market for capital. Still, we need to step up our efforts and our ambitions to remove remaining barriers to cross-border finance and allow for deeper harmonisation. This includes more aligned insolvency laws, more easily accessible financial information, simplified access to capital markets, particularly for smaller companies, robust market infrastructures, and more integrated capital markets supervision".

51. See for example Eurofi Views Magazine April 2023, From Capital Markets Union to Capital Markets Growth, R. Buenaventura.

52. *e.g.* in the clearing space.

53. Several actions in the latest CMU action plans published by the Commission may support this objective, including measures to improve the time to market of new product launches (*e.g.* in the clearing space), increase market transparency or the visibility of EU businesses such as the European Single Access Point (ESAP) or reduce disincentives to trading on EU markets (*e.g.* amending certain trading obligation rules).

54. See Eurofi Financial Forum Prague Summary – September 2022 – CMU: what can be done in this political cycle?

55. These latter objectives however face challenging issues such as the need to define effective sustainable finance guidelines and the importance of national prerogatives in the pension space.

may best contribute to the funding of different types of companies at different stages of development and tackling potential gaps (*e.g.* regarding innovative companies, scale-ups etc.). This also requires ensuring that rules applying to different financial activities do not disincentivize capital market financing – considering for example the impact of prudential rules on the role of banks as providers of liquidity and insurers as investors – and enhancing supervisory convergence within and across financial sectors.

Another debate is whether CMU-related legislations sufficiently emphasize the objective of developing long term investment – *i.e.* investment on the basis of the fundamental value and expected cash flows of assets – as opposed to shorter term investment focusing more on changes in market price[56]. Some observers consider that the real-time consolidated tape proposal for example, which is one of the main points of the MiFIR review may support more the latter objective.

The different CMU action plans set out since 2015 cover the main areas and drivers mentioned above to a large extent. A question going forward however, is whether the CMU should focus more on certain of these priorities to make decisive progress more quickly in terms of capital market growth and preserve the momentum of the CMU initiative. A second question is whether more specific actions would be needed to support adequately key strategic objectives of the EU such as the green and digital transitions and the EU open strategic autonomy agenda, in order to better materialize the added value of CMU, in a context where bank financing and public investment will be insufficient to support these objectives. A further question is whether CMU actions should not be more differentiated for Member States where capital markets are less developed and where the first objective may be to support and coordinate efforts to develop local markets, building on the existing TSI actions and those undertaken by the IFIs[57].

Appendix: Measures proposed following the September 2020 action plan

Legislative proposals published in November 2021

In November 2021, the Commission published **a first set of four legislative proposals** for implementing the September 2020 action plan, which are currently being reviewed by the co-legislators[58].

- **Setting up of a European Single Access Point (ESAP)** to public financial and sustainability-related information on EU companies and financial products in a digitally useable format
  - The ESAP will build on existing information channels and be developed, operated and governed by ESMA. Its objective is to make SMEs in particular more easily accessible and visible to both EU and international investors such as business angels, venture capital and private equity funds.
  - The Council agreed its common approach on the proposal in June 2022 and the ECON Committee report on the ESAP proposal was published at the end of 2022 opening the way for the start of the trilogues.
- **Improving the European Long Term Investment Funds (ELTIF) framework** in order to channel long-term financing to SMEs and long term infrastructure projects by making it easier for asset managers to operate and market ELTIFs and facilitating access to ELTIF funds for retail investors in particular, while maintaining high investor protection standards.
  - The ELTIF review proposes a broadening of the scope of eligible assets and investments and a reduction of certain fund rule limitations to allow fund managers to benefit from greater flexibility in the design of ELTIF investment strategies and portfolio compositions. A reduction of the investment threshold and the introduction of an additional liquidity window redemption mechanism were also proposed for retail investors.
  - The Council adopted its General Approach on 20 May 2022. The ECON Committee report was voted in June 2022 with a provisional agreement reached in October 2022. ELTIF should come into force at the beginning of 2023 now that the co-legislators have reached an agreement.

56. See for example ECMI policy brief n°33 How to make CMU work January 2023, which suggests that the latter approach focusing more on changes in market price (momentum investment) may be to a certain extent disconnected from underlying asset values and proposes introducing a minimum proportion of investment on the basis of expected cash flow within professionally managed portfolios as a condition of cross-border access to the European capital market.
57. Indeed many of the CMU actions may only have a limited impact in the member states where capital markets are very limited and where a first objective may be to develop multi-source financing combining capital market financing together with more traditional financing sources such as bank and public financing (possibly supported by NGEU). TSI: The Technical Support Instrument is the EU programme that provides tailor-made technical expertise to EU Member States to design and implement reforms. European IFI (International Financial Institutions) include the EIB, EIF and EBRD.
58. See for example Clifford Chance EU Capital Markets Union: an overview of key developments in 2022 – July 2022.

- **Enhancing the Alternative Investment Fund Managers Directive (AIFMD)** in order to better integrate the EU Alternative Investment Funds (AIFs) market, improve companies' access to diversified forms of financing, strengthen investor protection and enhance the ability of fund managers to deal with liquidity pressure in stressed market conditions.
  - The changes proposed include: the introduction of common minimal rules regarding loan-originating funds[59]; a harmonisation of liquidity management tools (LMT); a clarification of the rules on portfolio management delegation; measures to facilitate the use of depositaries on a cross-border basis[60]; and measures to remove reporting duplications and to facilitate access to relevant data by national and EU authorities. In addition the UCITS directive will be updated to reflect the changes made to the AIFMD where necessary[61].
  - The draft report of the ECON Committee was tabled in May 2022, and the vote is scheduled in Committee on 30 November 2022. The Council agreed on its general approach in June 2022
- **Reviewing the MiFIR regulation** in order to improve transparency and the availability of market data, improve the level playing field between execution venues and ensure that EU market infrastructures can remain competitive at international level.
  - The MiFIR review proposes the introduction of an EU-wide consolidated tape for shares, bonds, exchange-traded funds (ETFs) and derivatives based on close to real-time data and covering all trading venues aiming to improve the overall price transparency and provide investors with easier access to trading data. Secondly, a restriction is proposed on payment for order flow[62], as well as clarifications of the limitations on dark trading, reviewing current volume caps, waiver and deferral rules. Obligations for systematic internalisers relating to the publication of firm quotes and the matching at midpoint are also reviewed. Other proposals include the removal of the open access obligation for exchange traded derivatives[63] and an adjustment of the scope of EU share and derivative trading obligations[64] and aligning trading and clearing obligations for derivatives in order to increase the competitiveness of EU financial markets.
  - The draft report of the ECON Committee was presented in Committee on 19 July 2022 and the vote in Committee is scheduled on 31 January 2023. The Council reached a general approach on the MiFIR review in December 2022 on which negotiations with the EU Parliament can start.

Additional proposals published in December 2022

The Commission published in December 2022 an additional package of three legislative proposals for consolidating the CMU, building on the September 2020 action plan.

- **A Listing Act** aiming to simplify listing requirements for companies, particularly SMEs, wanting to raise funds on public markets by cutting unnecessary red tape and costs. The proposed amendments include: (i) the simplification of the documentation that companies need to produce and the streamlining of the scrutiny processes by national supervisors; (ii) a simplification and clarification of certain market abuse requirements; (iii) measures to encourage the production of more investment research, particularly for SMEs; and (iv) the creation of multiple vote share structures allowing the founders to retain sufficient control of their company after listing, while protecting the rights of the other shareholders.
- **An initiative on corporate insolvency** aiming to reduce fragmentation and make rules regarding value recovery more predictable for creditors. Proposals include (i) the harmonisation of specific aspects of insolvency proceedings across the EU[65]; (ii) the introduction of a simplified regime for winding down micro-enterprises; and (iii) the requirement for Member States to produce an information factsheet on the key elements of their national insolvency laws in order to facilitate decisions by cross-border investors.

59. *i.e.* the direct lending by AIFs to companies. These rules will allowing them to operate cross-border and addressing potential risks related to this type of lending.
60. The possibility for National Competent Authorities to allow AIFs to appoint a depositary situated in another Member State; measures to allow depositaries to obtain the necessary information for their oversight duties when fund assets are safekept by a CSD.
61. For instance on LMTs, delegation and reporting.
62. Whereby retail brokers forward the orders from their clients to a limited number of traders in exchange for compensation.
63. In order to improve legal certainty and suppress disincentives for exchanges to create innovative financial products. Open access provisions for exchange-traded derivatives indeed reduce the attractiveness for exchanges to invest in new products as competitors may be able to get access without the upfront investment, according to the Commission.
64. The proposal would refine the perimeter of the share trading obligation (STO), which requires that the majority of trading in shares takes place on trading venues or systematic internalisers, to clearly limit it to EEA ISINs. This would clarify that the exemption to the STO for shares which are infrequent, irregular or ad hoc applies to EEA shares. In addition the proposal would introduce a possibility to suspend the derivatives trading obligation (DTO) for certain investment firms that would be subject to overlapping obligations when interacting with non-EU counterparties on non-EU platforms.
65. For example concerning rules on the preservation of the insolvency estate, creditors' committees to ensure a fair distribution of recovered value among creditors, so-called "pre-pack" proceedings and the duty on directors to timely file for insolvency.

- **Proposals to strengthen European clearing** including measures to (i) simplify procedures for the launching of new products and the changing of risk models by introducing a non-objection approval for changes that do not increase risks for CCPs; (ii) enhance the framework for clearing commodity derivatives by requiring margin models to be more transparent, improving CCP participation requirements to be met by corporates and broadening CCP eligible collateral; and (iii) require market participants subject to a clearing obligation to clear a portion of products deemed of substantial systemic importance through active accounts at EU CCPs.

Proposals planned for H12023

Further proposals are due to be published during the first semester of 2023, covering other aspects of the September 2020 CMU action plan:

- **A Retail Investment Strategy is due to be published in H12023** following assessments conducted in 2021 and 2022 on the key issues to tackle with regard to retail investment[66]. This proposal is expected to focus more specifically on how financial products are distributed and the handling of inducements, on financial advisors and how suitability and appropriateness assessments are conducted and on the information that investors receive, particularly in a digital environment.
- **An Open Finance framework** aiming to allow data to be shared and re-used by financial institutions for the creation of new services[67] in different sectors of finance including capital markets. This proposal intends to provide a level playing field for existing and new entrants and will build on the work undertaken in the context of the upcoming Data Act and the on-going evaluation of the Payment Services Directive II (PSD II). In addition, the Commission will propose a supervisory data strategy to improve data standardisation and sharing in order to enable supervisors to efficiently collect and use the data they need to perform their tasks, which involves a modernisation of EU supervisory reporting.

The publication of proposals concerning withholding tax procedures and securisation had been anticipated, but it is unlikely that these will be proposed in the coming months:

- **A targeted legislative proposal regarding withholding tax procedures** which hinder cross-border investment with late refunds and high costs.
- **A way forward on securitisation** on the basis of input from the ESAs. A report was published by the Commission in 2022 on how the securitisation regulation is working that concluded that the regulation generally works well, but that targeted improvements should be made, notably on the proportionality of certain requirements.

66. A consultation was conducted by the Commission between May and August 2021 aiming to identify the main issues to tackle in the Retail Investment Strategy and the MiFID II, IDD and PRIIPs reviews with regard to retail investment. More focused assessments were conducted in 2022 by the Commission and the ESAs on suitability and appropriateness assessments, disclosures, inducements, product complexity and digital channels.

67. Provided that customers agree to it and subject to data protection rules and clear security safeguards.