CMU: WHAT CAN BE ACHIEVED BY Q1 2024?

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From Capital Markets Union to Capital Markets Growth

The CMU project has been flying around since 2015. There were two main goals: to make capital markets more integrated and to make them larger, attracting more companies to them. I think the time has come to concentrate on the second objective.

The word "Union" is starting to become misleading of the true priority, growth, for three reasons.

First, because it implies that regulation or supervision of securities markets are still fragmented. Maybe this was the case in 2015, but it is not anymore in 2023. Since 2015, we have in place a fully harmonized regime, through regulations, for registry and settlement (CSDR), prospectuses (Prospectus Regulation), EMIR Regulation, and trading and reporting (MIFIR). We have a single settlement point in the Euro area (through T2S). We have also made good progress on true convergence of supervision of issuers of securities. ESMA has reinforced powers and brings deeper convergence each year. Financial reporting and prospectuses, the two main avenues through which issuers inform the markets they tap, are so closely aligned across Member States that even ESMA recognises this through its public reports. Some areas do require further progress, like a single point to access information on issuers and products or the consolidated tape. But those are information systems, not a transformational initiative of market structure or integration.

Second, because the word union resonates unhelpfully to Banking Union, in which the priority was to centralize the supervision of the largest players, as a response to the sovereign debt crisis due to the link between banking and sovereign risk. Nothing of this sort is needed today in capital markets. We are not facing any "market failure" in terms of wrong way risk or supervision shortcomings that would require to reshuffle the deck of supervisory competences.

And third, because in practice companies and investors are already freely picking their market of choice. There are Spanish companies that issue and list bonds in Ireland, or that decide to register their shares in the Netherlands or in Portugal. We have companies from Luxembourg, Romania or France listing their shares in Spain. We have CSDs and CCPs from all these countries providing services to issuers and investors seamlessly in other Member States. And we have 50% of the investment funds bought by Spaniards coming from other Member States.

The comparison with banking markets is striking. We just need to compare where investors place their savings (in funds investing all over Europe) to where depositors hold their deposits (almost exclusively in banks of their own country). Or compare where companies that go public have their shareholders (all over Europe and the world) with where companies obtain their bank financing (almost exclusively in their own member state).

Although EU capital markets are reasonably integrated, way more than banking markets, they are scaringly small. We still have 3 times less market-based financing than the US. The primary equity markets have run dry in the last two years in many countries. With governments having to consolidate public finances in the next decade and banks facing new and increased risks, that is a truly risky situation for the European economy. Without larger and deeper capital markets, EU companies will not be able to finance the huge investments they face to accommodate the two large transformations: digital and green. We need to pursue, urgently, deeper capital markets, not more integration. It's more market-finance growth, not "union" what matters now.

How to do that, is sufficiently understood by the Commission and the co-legislators. The plan is there, we just need to deliver it. We need to make it cheaper, simpler, and quicker for companies to tap the markets (through the Listing Act and similar initiatives, including tax incentives). We need to make it easier, safer, and simpler for retail investors to invest in bonds and shares, either directly or through investment funds (through the AIFMD/UCITS and Retail Investment Strategy initiatives).

We need to make it cheaper and simpler for institutional investors to access the already highly comparable information (ESAP). And, very importantly, we need to break the equity-debt asymmetry that companies face when deciding how they finance an investment (through the DEBRA initiative). This tool, DEBRA, is probably more important for the attraction of EU companies towards equity markets than any of the other "classical" CMU initiatives.

And we need to do that quickly and boldly. With ambitious timelines and enough determination. But in order to be effective, I think we need to concentrate and focus now on the G (of growth).

CARMINE DI NOIA

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Capital markets are the tools that will enable the twin transitions

Before starting to build a house, it is wise to have a design drawn up. That plan helps guide the process and provides a yardstick against which to measure progress. The EU has such a plan for its twin green and digital transitions, the proverbial house in question. It is ambitious, and rightly so given the size of the challenges ahead. It involves significant cuts to greenhouse gas emissions, a decoupling between economic growth and resource use, and a ramp-up of Europe's technology development, to highlight a few key points.

An equally important part of housebuilding, however, is to have the right tools with which to execute the design. When it comes to this aspect, the EU toolbox looks somewhat smaller than the envisioned house calls for. The green and digital transitions will require truly enormous investments. The European Commission estimates that delivering on the European Green Deal will require an annual increase in investment of more than half a trillion Euros over the coming decade. The majority of that money corresponds to the decarbonisation of the economy, a task that will certainly require new technology. From an investment perspective, that means funding uncertain ventures.

The question to consider is therefore how to mobilise these funds, what tools to use. Market-based financing is suitable to funding innovative ventures with uncertain returns because it offers risk-willing, long-term capital and disperses risk across a large universe of investors. That is why the OECD works to promote their development. Indeed, capital markets have already played important roles in previous large-scale transitions in history, such as the expansion of railway networks. Importantly in the context of the green transition, research shows that higher shares of equity financing are associated with lower per capita carbon emissions.

As OECD work has highlighted, market-based financing can also often offer more flexibility when it comes to debt, in particular in times of crisis when bank lending tends to contract. A lack of access to such flexible capital, debt and equity, can constrain innovative companies from developing new technologies, to the detriment of both economic growth and decarbonisation.

In other words, capital markets have a key role to play in enabling the EU's twin transitions. Unfortunately, Europe is presently punching below its weight when it comes to market-based financing. The EU economy is one of the world's largest, but you would not know based on its capital markets. The EU's share in global capital market activity is significantly smaller than its share in global GDP. That is true for total market capitalisation, for IPOs, for SPOs and for corporate bond issuances. The US' public equity markets are more than four times larger than the EU's, a gap considerably larger than that between the two regions' GDP. In the list of the top ten jurisdictions globally by number of IPOs in the past decade, there is only one EU country (which also happens to host this edition of Eurofi – Sweden). This may help explain why there is also just one EU firm in the world's top ten most valuable public technology companies (six are in the US and three are in Asia).

A key priority, then, should be to increase the dynamism of the EU's capital markets. A first step towards that goal is to begin weaving together something that can actually be called "EU capital markets" in the first place, rather than the current mosaic of national markets with different supervision, regulations, taxation and insolvency systems, to mention a few obvious obstacles to increased cross-EU activity. The Capital Markets Union sets out an ambitious agenda in this respect, and its successful implementation will be key to ensuring that EU companies have access to the capital they need to invest and grow.

The EU economy is one of the world's largest, but you would not know based on its capital markets.

However, equally important is to acknowledge that EU capital markets do not operate in a vacuum, but form part of a much bigger global market. The total market capitalisation of companies listed on EU exchanges represents 10% of the global total. That leaves 90% of the world's market capitalisation outside of the EU. Ambitious regional standard-setting is good, but it should not come at the expense of global capital market coherence. Such fragmentation is not in the long-term interest of EU Member States and their citizens.

Still, there is reason for optimism about the green and digital transitions. Europe is full of capable people eager to begin building towards the EU of the future, our common house. Let's make sure they have the tools to do so.

BENOÎT DE JUVIGNY

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Supervision: the key remaining factor to complete a fully-fledged CMU

The completion of a fully-fledged Single Market for capital is essential for the European Union to compete and lead globally. It has become even more important in a redesigned setting of the Union, and at a time where the financing needs of EU companies dramatically need to be met to sustain and develop the European economy.

Progress in this respect has been desperately low. Eight years after the launch of the first CMU action plan, enhanced supervision at EU level remains a missing piece of a well-functioning Single Market for capital. This is problematic on multiple levels; more consistent interpretation and application of the rules across Member States (MS) is always necessary to ensure a level playing field for all market players and eliminate arbitrage opportunities. But beyond that immediate shortfall, the lack of a truly unified supervision at EU level creates an incentive for colegislators to go into incredible details, thereby contributing to the overall regulatory fatigue and hampering the quality of EU legislation.

Supervisory convergence is useful and is under way, but it leads to an enormous burden on national competent authorities (NCA) and ESMA, which is disproportionate to their available means. Above all, given the growing digitalization of financial services, the loopholes of the EU supervisory structure creates room for non-compliance and ends up being detrimental to investors, mainly retail. In the long run, this is an issue for the whole European project.

Yet, previous legislative attempts towards more integrated EU supervision have not received enough political backing from MS, despite a broad consensus on the need for a consistent implementation of rules across the EU.

In view of the development of digital distribution, if no progress can be made to reinforce supervision at a European level, then *a minima* one should reconsider the functioning of supervision in the context of cross-border activities within the EU and the balance of powers between 'home' and 'host' national supervisors. As digitalization grows, it appears necessary to strengthen conduct supervision in cross-border retail financial services.

Indeed, the supervision of cross-border provision of financial services to retail within the Single Market is currently exclusively performed by NCA. In practice, there are however limits to the effectiveness of the supervision undertaken by 'home' NCA on the conduct of firms in 'host' MS. Experience shows that, as far as consumer protection rules are concerned, home NCA tend to lack the proper expertise to perform this task, notably in terms of knowledge of the local market in other jurisdictions (language, marketing and sales behaviours). This renders difficult for home supervisors to properly monitor cross-border activity of firms in host MS. It is undesirable that firms that offer cross-border services are less effectively supervised than those operating in their 'home' jurisdiction.

ESMA published a peer review on supervision of cross-border activities in 2022, and made use of ESMA Regulation (Art.16) to follow up on recommendations made to address the shortcomings observed at the home NCA level; but these tools are too heavy to implement.

Therefore, a new balance of responsibilities should be considered, to enhance consumer protection while retaining the full benefits of the Single Market. Concretely, the EU supervisory framework should be reviewed to provide broader abilities for a host NCA to effectively exercise supervisory powers where financial firms undertake meaningful activity in its jurisdiction, including under the freedom to provide services (as well as an effective system for the exchange of relevant information between authorities). The intervention of host supervisors and ESAs should be facilitated to let them to intervene in timely fashion in the event of serious risks to investor protection and the proper functioning of markets.

Moreover, the principle that the host NCA's responsibility with regard to conduct supervision is triggered by a physical office (i.e. a branch) in the host Member State should be revisited, given the rapid rise of digitalization of financial services. The host supervisor's understanding of local market specificities puts it in a better position to identify possible issues with the conduct of financial firms in their jurisdiction – as well as to devote resources to an issue affecting local consumers and manage complaints.

Finally, the principle whereby an investment firm should provide at least a part of its services in the MS where it is authorised must be clarified and enforced, to avoid regulatory forum-shopping which undermines the Single Market.

The forthcoming *Retail Investment Strategy* is an opportunity to formalize these proposals. But in any case, these adjustments can only be a second best to compensate the absence of an integrated EU supervision. The direction that should ultimately be followed to complete the CMU remains that of a true European supervision.

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What is next for the European Capital Markets Union?

As we are celebrating the 30th anniversary of the European Union (EU) single market, where are we truly in achieving the four freedoms of movement? Well, we still are not there yet. One often forgets that free movement of capital is still a work under construction.

Having an integrated freedom of movement of capital is a central piece of the puzzle when it comes to fulfilling the internal market. This is precisely why the Capital Markets Union (CMU) initiative was launched in 2015, but Europe is still struggling to finalise it.

Compared to other continents, the EU is falling behind when it comes to developing its financial markets. Our main weaknesses are no secret. To name a few, our markets still remain highly fragmented, our financial sector is highly overbanked and the retail investors are not incentivised to invest.

Regulation and its successful implementation represent only a small part of the solution. This makes the CMU project a common one, as it must mobilise citizens, businesses, supervisors and many more.

Current files on the table precisely aim to knock down fragmentation between our capital markets. The European Single Access Point and the revision of the Markets in Financial Instruments Regulation (MiFIR) have been great achievements in that sense.

In the CMU, more than 99% of EU companies are SMEs. Yet, the current framework is not incentivising them to diversify their sources of financing. The Listing Act proposal is a great example of legislation aiming at increasing the attractiveness of our framework for smaller companies. We need, among others, to reduce the administrative burden for companies to list on the stock exchange. SMEs, which are the heart of our European economy, are the first ones to be prejudiced by unnecessary red tape.

Additionally, we should not lose sight of our European objectives. Above the long-lasting will to complete the CMU, many additional challenges are guiding its construction. Today we not only need to channel private investments into the green and digital transition, but we also seek to achieve strategic autonomic.

Following this approach, the new clearing proposal comes in timely to reduce our exposure to third country Central Counter Parties (CCPs).

We are going in the right direction but it is not going fast enough, as we are still far from achieving the CMU.

The question is, what meaningful step should we take moving forward? The long awaited Retail Investment Strategy is more than just an important upcoming piece of legislation. This represents our last chance to act. How can Europe compete globally if it is still lagging behind in achieving a Capital Markets Union? A lot needs to be done. The strategy will thus need to address a wide range of issues and we cannot let the inducement debate overshadow other equally important topics.

A particular emphasis should be put on facilitating access to financial markets, reducing red tape, better regulating investment advice and most importantly, emphasise the urgent need to promote financial literacy. Europe is lacking when it comes to financial education and we need to change that. As compared to other countries, where finance is introduced at early ages in the school system, financial education remains almost non-existent in the European Union. Financial literacy is the key to removing obstacles standing in the way of retail investors' engagement, be it their lack of trust or fear of the unknown.

Furthermore, the success of the CMU will depend on broad access to financial advice, especially on local level. Local networks ensure access to finance in all parts of European territories (regions, small cities, villages, etc.).

It is true that the current business models need to be improved through adequate investor protection, bias free advice, promoting an open economy and transparent, comparable and understandable product information. Enhancing our current system will serve the long-term interest of the end investors and enable them to have, affordable and personalised financial advice as well as equal access to a broad range of financial products, with safeguards.

The success of the CMU will depend on broad access to financial advice, especially on local level.

Meaningful change does not happen quickly. European history has proven to us the virtue of following the Union's famous step-by-step approach, but we waited long enough.

Our current priorities should be the setting stones of tomorrow's Capital Markets Union, be it strategic autonomy, the green and digital transition, our companies' competitiveness, consumer protection and supporting financial literacy.

It is our collective responsibility to ensure that this strategy will be a success. If we want a true Capital Markets Union, there is no more time to waste. Citizens, businesses, national and European regulators will all need to grab this opportunity to aim for one possible outcome: its success.

CHRISTIAN CASTRO
Head of Public Affairs - CaixaBank

Progress and challenges in the Capital Markets Union

In a nutshell, the main aim of the Capital Markets Union (CMU) is to ensure that "capital markets in Europe" get closer to a "European capital market". This means breaking down barriers to the cross-border flow of investments and savings across the EU. Why to do this? To benefit consumers, savers/ investors and companies by increasing the opportunities they have to invest and borrow, lowering costs and increasing risk sharing. All this should ultimately lead to a more integrated, more diversified and less fragmented EU financial system.

The CMU initiative was initially launched in 2015, with a new action plan announced in September 2020 by the European Commission. The plan included 16 actions to achieve three main objectives. First, in light of the Covid-19 pandemic, to strengthen existing funding sources (for example to SMEs) and to consider ESG goals and digital transformation, the first objective was to support a green, inclusive and resilient economic recovery. Second, with a focus on retail investors, which low participation in capital markets remained a concern, the second objective was to make the EU an even safer place for individuals to save and invest long-term.

Finally, in order to address barriers in the areas of taxation, non-bank insolvency and company law, the third objective was to integrate national capital markets into a genuine single market.

Both the overall guiding objectives and the corresponding policy actions are deep and broad ranging. Include aspects such as information accessibility and regulation of long-term investment funds, alternative investment funds and financial instruments. As a result, the CMU clearly is one of the central projects in the EU, also connected with the need to complete the Banking Union.

Within these policy objectives and actions, certain aspects are related to long-established national practices and existing historical divergences in legal frameworks. Accordingly, as usually occur in many areas of European and international regulation, to strike a right balance between harmonisation/ standardisation and due consideration to countries' common heterogeneity, for example with regards to their economic structures and legal tradition, is a challenge in itself.

Among these challenges, a key remaining structural barrier to overcome is the existing heterogeneity in national insolvency law across EU members. Progress on this side should help to cross-border investments while increasing regulatory consistency across the EU. Some specific areas where further improvements could be made include adding clarity on definitions (eg: insolvency proceeding), the protection of creditors' interests, and avoiding unwarranted complexity in the timelines for the proceedings.

In addition, as previously mentioned, the CMU should translate into tangible benefits for investors, also contributing to advance towards a broad and inclusive investors base. To that purpose, the Retail Investment Strategy (RIS), which the Commission has planned to present in the first half of 2023, seeks to ensure that retail investors can get full the benefits from capital markets and coherent rules across legal instruments. More concretely, such benefits should materialise in adequate protection, advice, and information, as well as in efficient costs and access to a variety of financial services and products.

In this context, investment advice results indispensable to ensure that financial services and products do meet the specific needs of retail investors, including their risk appetite and investment horizons. And, to achieve this, it is particularly important to ensure that different types of financial advice are maintained. Financial advice should be able to adjust to the different profiles and characteristics of investors.

The CMU should increase opportunities to invest and borrow, without affecting retail customers.

Consequently, any potential regulatory change on this front should be extremely mindful of practical effects, implications, and unintended consequences. As such, potential regulatory proposals should be carefully assessed, and special attention should be given to the distinctive characteristics of different types of financial services and products.

Ultimately, the whole set of possible policy actions should ensure a proper and gradual transition, without abrupt moves, which is critical to avoid affecting retail customers. Measures that may well end up in lack of information and in a lower quality of invertors' saving and investment decisions, should clearly be avoided. All the latter is especially relevant for the most vulnerable segments of the population.

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CMU retail participation - The 'how' still needs to safeguard the 'why'

In the City, they sell and buy
And nobody ever asks them why[1]

From its inception the Capital Markets Union (CMU) has been particularly clear on the social purpose of capital markets and the financial firms that operate within them. As the economist John Kay reminds us, financial services are only ever intermediating "other people's money" - that is, channelling funding from citizens with savings and investment needs (to support risk management and retirement) into economies (to support jobs, growth and sustainable ambitions). [2]

By speaking of the need for policy to foster "retail participation" in the capital markets in the same breath as the need to improve SME access to funding, the CMU has aspired to operate on the same understanding - that financial firms are the 'servants of the people' not 'masters of the universe'. SME funding is, after all, "other people's money" and the people should know and celebrate the fact.

It is a shame, then, that the retail participation leg of the CMU has drifted into the Retail Investment Strategy (RIS), which has itself been allowed to drift into a seemingly single issue debate over the cost of investment advice.

The following five Ps might help correct this drift.

At the political level the RIS needs to move away from the cost of advice. For one thing, marginally cheaper advice won't foster retail participation by bringing the currently unadvised into the advice world. The majority of the unadvised are either unaware of advice in the first instance, or think it is something that 'other people' do. Worse, the proposed retrocession ban risks pushing the currently advised out of the advice world, with knock-on effects for the distribution of sustainable and productive products such as the ELTIF. Both are key EU political projects and yet both types of product are distributed predominantly by advice. We would prefer to see stronger focus on value-for-money and better disclosure across both products and distribution services.

In the meantime, we think non-advised online digital access points are the real key to the retail participation the CMU seeks. Online is where customers are and where digital access points can coach them towards better financial health - managing debt, establishing cash saving, moving into investment as appropriate, and protecting the whole with insurance. Non-advised / robo-advised platforms are therefore where the RIS should also focus, both addressing blockers to online customer-journeys (especially paper-based fund disclosure) and leaning into accelerators of change (digital ID; robo-suitability; and tailored or 'personalised' communication).

The key accelerator here remains Open Finance because of the way it will enable customers to view their financial health as a portfolio of assets and liabilities - from consumer debt through cash savings to pension and private investments. This helicopter view is itself an important element of financial literacy, but it is currently the preserve of advised (and often only wealth-advised) customers. Open Finance can change that, throwing the same portfolio view open to all.

Online tools can then coach consumers towards financially healthier portfolio mixes incorporating on-risk investment where/when appropriate. Tools can also help consumers shape bespoke portfolios (around environmental or social sustainability goals), as well as to exercise their power as equity shareholders (via proxy voting).

We hope there is still time in the political cycle to re-energise meaningful 'retail participation'.

Of course, such innovative forms of online engagement will require innovative forms of investor protection. For example, BaFin speaks of the need to safeguard the consumer's 'data sovereignty' in environments where vendors arguably know more about their customers than customers know about themselves.[3] But it is important to remember that in an era of smart phones, smart cars and smart fridges, digitally savvy customers are smarter too.

We hope there is still time in the political cycle for RIS to make these crucial pivots - for example towards the Open Finance Experts Group's vision of Open Investment data transforming financial advice.[4] With a pivot we can still drive meaningful retail participation in the CMU project. Without it, we risk re-consigned capital market investment to something that only 'other people' do:

But since it contents them to buy and sell
God forgive them, they might as well

[1] *Humbert Wolfe, The Uncelestial City (1930).*
[2] *John Kay, Other People's Money: masters of the universe or servants of the people? (2015).*
[3] *BaFin, bp_18-1_digitalisierung_en.pdf (fid-intl.com)*
[4] *Open Finance Experts Group, 2022-10-24-report-on-open-finance_en.pdf (europa.eu)*

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The EIF, on the forefront of European risk investment in innovative SMEs

The European Union (EU) financial system has historically been and still is bank-centric. Despite a positive market development in Europe, venture capital and equity investments are much higher in the United States and some Asian countries. The number of IPOs in Europe is low, listed European firms disproportionately rely on banks for funding, and innovative European companies are likely to be acquired by American or Asian firms.

These are symptoms of an underdeveloped capital market and raise concerns about the effects of Europe's overreliance on banks. The traditional argument favouring alternative funding is that the dwarfism of capital markets constitutes a bottleneck to enterprises' ability to access resources and absorb shocks.

Some ancillary arguments accompany this observation: economies that rely heavily on bank financing present lower growth rates, rebound slowly from downturns, are more prone to crises and less innovative. [1]

One additional argument against over-reliance on bank credit has become relevant nowadays. During the COVID-19 years, public and private debt expanded[2]. This was the result of companies' need to bridge their financing during the pandemic and of State support policies. In the current environment of rising interest rates, this large debt stock raises concerns about sustainability.

The response to the double challenge of funding bottlenecks and debt sustainability lies in the diversification of funding sources and in the growth of cheaper, risk-prone, and patient capital markets. Beyond easing the debt burden, this will provide financing better suited to innovative companies that will push forward the green and digital transitions.

In this context, completing the Capital Markets Union (CMU) is an urgent need. The free flow of capital across EU countries is a founding principle since the Treaty of Rome, but the CMU is more than that. Europe needs a unified and lively market, with harmonised supervision and insolvency rules, where there are no regulatory barriers, and where information can be easily accessed across countries.

The European Commission's 2020 action plan pushed forward some positive changes in recent years. But further reforms are needed, especially in the fields of debt bias of taxation systems, data access, harmonization of solvency rules, strengthening of pan-European governing and supervision, and financial literacy and engagement.

However, reforms alone cannot unilaterally transform a market. Market actors need to witness how investing across the EU is feasible and economically attractive. International financial institutions play a crucial role as market enablers and investment catalysts.

Since its creation in 1994, the European Investment Fund (EIF), the subsidiary of the European Investment Bank (EIB) that specialises in providing risk finance to small and medium-sized enterprises (SMEs) and mid-caps across Europe, has embodied this role. It aims to satisfy existing, and future market needs by designing innovative financial products addressed to its financing partners, acting as financial intermediaries.

The EIF carries out its activities using its own resources or those provided by the EIB, the European Commission, EU Member States, or other third parties, including private investors.

These resources are deployed across Europe[3] to finance high-growth innovative companies in various stages of their life, from seed investment to scale-up and maturity, through participation in venture capital and equity funds. With these resources, the EIF also seeks to fulfil policy priorities aligned with the EU's objective of enabling the green and digital transition and pays particular importance to additionality, supporting the closing of funds across the EU.

We hope there is still time in the political cycle to re-energise meaningful 'retail participation'.

As many SMEs seek financing through more traditional routes, the EIF also provides guarantees and securitizations. These products are uniquely placed to support the economy through their ability to transfer risk while enhancing banks' capacity to manage their balance sheets efficiently to continue lending.

The EIF's efforts since its creation have been enormous. It has invested more than €38 billion in equity products and invested more than €82 billion in guarantees and securitisations, leveraging in total more than €530 billion.

Companies in different stages of their lifecycles need different financing tools, and evidence from many crises shows that the diversification of funding sources improves resilience during cyclical downturns.[4]

The EIF's actions diversify the availability of financing sources and are entirely in line with the objectives and spirit of the CMU, which is far from complete, but a bit closer thanks to the EIF activity.

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