EU capital market competitiveness and integration

1. Main objectives and issues at stake

The Chair noted that competitive capital markets need to be sufficiently liquid and deep and function as efficiently as possible with the least frictions possible. Developing more competitive capital markets in the EU is an important objective for enhancing the financing of the real economy and also optimising the distribution of risk across actors and investors based in different EU member states.

An industry representative stated that competitive EU capital markets are needed to support the strategic autonomy objectives of the EU. There is a permanent tension between this objective and the desire to increase competition in the EU market which usually involves widening the access to the EU market for non-EU players in order to answer the immediate needs of consumers. In essence, the EU has a choice between being a 'finance-maker' and a 'finance-taker'. Europe has traditionally been a continent of finance makers, where many European and global financial institutions have developed. However, European regulation over the last 20 years has resulted more in opening up the EU market to competition from non-EU players, than strengthening the EU financial industry. There is also an unbalance at the international level because EU financial institutions do not benefit from the same opportunities in most non-EU markets. This could result in a progressive marginalisation of EU players and a reduced availability of competitive financial services in the EU. While developing one's own financial sector is much more difficult than just buying services from foreign companies, that is essential to make sure that Europe's future economic growth and the European social model can continue to be funded. Europe should ensure that it controls the key financial players and infrastructures needed to support this objective.

A second industry representative agreed that stronger capital markets could enhance the resilience and growth prospects of the EU economy. This is the objective of the capital markets union (CMU) project launched in 2015. At present, there is a high degree of product bias in the EU, with enormous amounts of wealth held in bank deposits. Roughly 40% of household wealth is in deposits in the EU, compared to 13% in the US. This capital is not flowing into the capital market and not contributing sufficiently to the financing of the real economy. There is also a very strong home bias, where people tend to buy local securities if they buy any at all. Europe has demonstrated a greater accessibility of its market to foreign investors than other regions. 44% of euro area equity is owned by non-EU actors, compared to 17% in the US or 30% in Japan.

A third industry representative stated that Europe must be a finance-maker and build sufficiently competitive financial markets, otherwise all market participants will lose. Continuous innovation is crucial in the capital markets industry. Self confidence is also important, because Europeans tend to unnecessarily talk themselves down, particularly on the global stage. There should be more focus on promoting and further developing European best practices and strengths. This will provide a positive momentum for the CMU. One strength of Europe is the very deep talent pools. Every country in Europe has very good universities training students in subjects that are relevant for finance and capital markets. In addition, there is a strong desire among market players to make progress on the CMU and strong political support for this objective, which needs to be capitalised on.

An official noted that there has been much focus for a long time on consumers in European legislation. Strengthening EU capital markets, which is the overarching objective of the CMU, requires enhancing the competitiveness of the EU financial sector and of the main EU financial players. Strong actors with international reach, with headquarters and substantial teams based in the EU, are needed to contribute to the massive financing that is required to support innovation. Staying competitive with regard to China and the United States is the main challenge facing Europeans in the years ahead. Financial actors that are here to stay, even in bad times, are needed to meet this challenge because foreign actors tend to reduce their activity abroad in times of crisis. During the 2022 energy crisis of last year, having strong actors based in the EU able to tackle the issues posed by the crisis proved to be crucial.

A regulator commented that there should not be a trade-off between regulation and attractive markets as is sometimes suggested in discussions about competitiveness and strategic autonomy. Deregulation should be avoided because it might lead to a race to the bottom. On the contrary, a sound, strong regulatory framework and well-designed rules support well-functioning, orderly markets. Markets are particularly fragile in the present complex economic and geopolitical situation. The EU needs well-functioning markets to weather those storms. Deep capital markets that can finance the growth of economies and support the green and digital transitions are urgently needed. Brexit has put the spotlight back on the importance of developing EU capital markets and strengthening market participants based in the EU, which is positive for the future.

An official noted, with regard to earlier comments about strategic autonomy, that an effective CMU will only function if it is open to the rest of the world. Care must be taken not to build a fortress but to attract capital from other regions into Europe.

2. Main areas of improvement in terms of capital market competitiveness

An industry representative emphasised that at present, there is not one single European capital market but a series of separate capital markets, which reduces the overall level of competitiveness of EU capital markets. Capital markets represent around 40 to 50% of GDP in the EU on average, compared to roughly 150% of GDP in the US. In terms of level of coverage of issuers by analysts, the EU and US are similar with roughly 22 analysts per company greater than $30 billion market cap in the US, compared to 19 in the EU. This suggests that the lower level of capital market financing in the EU is not due to the poor coverage of firms, but rather to fragmentation and the smaller size of capital markets.

A second issue is that savings are not being channelled sufficiently into productive capital opportunities to power the growth needed in Europe. Improving the financial education of European savers to empower them as investors should be a priority. There is already a positive dialogue between the European Commission and the OECD on these issues but this needs to lead to a more concrete plan to mobilise the savings capital. Further reform in the pensions area is also needed to channel more deposits to the EU capital markets. One of the best elements of the CMU action plan is the idea of exploring auto-enrolment, following the example of the German *aktienrente*.

A number of other areas could be harmonised, the industry speaker suggested. There are very different rules in terms of corporate control in the EU. Public takeovers are regulated differently despite the 2006 takeover directive and there are different thresholds for mandatory offers and different treatments of parties acting in concert. There is also the notorious issue of the lack of harmonisation of corporate insolvency rules. Not only the insolvency framework but also the process must be harmonised. Without a common approach to insolvency and foreclosure, there is no hope of unlocking the securitisation market in the EU either. The collateral that is viewed and is ultimately accessible as a credit enhancer should also be available in a similar way.

A third industry representative stated that the liquidity and the volume of EU capital markets are not sufficient relative to the size of the EU economy. From a global perspective, ground has been lost by the EU since the 2008 financial crisis. Despite the declared intention to further develop EU capital markets and reduce dependency on bank financing, the perception in the market is that insufficient progress is being made. Priority has been given to regulation over innovation. In addition, doing business in Europe is still like doing business in 27 different nations. Investors continue to confront diverging tax regimes, insolvency laws and post-trade practices. For example, market-making activities face different regulatory treatment across member states. In effect, there is a single rulebook but no harmonised supervision or enforcement of that rulebook, with the result that member states implement EU rules differently. A further issue is that too few retail investors are attracted to the capital markets in the EU. Increasing retail participation would benefit EU citizens and the economy and contribute to individuals' retirement savings with more diversified and competitive investment choices. A greater diversity of market participants also contributes to a more sustainable growth of capital markets and to more resilient and robust markets. Further transparency of markets, with lit order books, clear rulebooks and central infrastructures such central counterparties (CCPs), will also foster more liquidity in the EU capital markets, improving their competitiveness.

An official echoed the comments made about the insufficient competitiveness of EU capital markets and the need to adopt a more ambitious course of action with the CMU. In Europe there is still a high reliance of corporates on banks compared to the US and capital markets are under-developed. Banks represent 55% of corporate financing in Europe compared to 33% in the US. Equity markets in the EU are three times smaller than they are in the US. Moreover, only 11% of EU SMEs reported that equity funding is important for them in a recent survey. Venture capital, which is essential for financing the green and digital transition is also insufficiently developed in the EU, representing 0.2% of GDP, compared to 0.6% in the US. Cross-border equity and debt holdings have hardly changed since 2014. The important role of capital markets in terms of risk sharing and resilience also needs considering, but capital markets contribute only 5% to risk sharing in the EU, compared to 35% in the US, where they play an important role in shock absorption.

A regulator commented that although much has been done collectively to develop a single rulebook and harmonise rules in a number of areas such as consumer protection, wholesale trading and financial market infrastructures, progress is still needed in some key areas. Equity markets and IPOs are still lagging behind. There are also some frustrations around cross-border fragmentation that need further work.

An industry representative stressed that while some CMU actions, such as the Listing Act, which aims notably to introduce a single prospectus in Europe similar to the S1 form in the US, are relevant for the development of capital markets, too much energy is spent on issues that are not essential. This is slowing down the overall reform process. In the ongoing debate about the consolidated tape, most of the discussion is about how to reduce the cost of real-time transaction data for sophisticated professional users such as asset managers and market-makers, but this type of data only represents 15% of the total cost of data for the finance industry in Europe. The remaining 85% of the cost of data for European users, which is mainly provided by the major US and UK data and information consolidators, is totally outside of scope of the EU work.

3. Measures needed to enhance the competitiveness of EU capital markets

3.1 Improving the supervisory approach to capital markets in the EU

An industry representative stated that the role of ESMA and whether further supervisory coordination is needed at EU level to support the development of EU capital markets should be re-evaluated. The implementation of consolidated supervision in the banking sector under the aegis of the European Central Bank (ECB) has been very positive, but there has not been the same development in the securities market. Work is ongoing on supervisory convergence, but that might not be enough. Some other measures should be considered. For example no-action letters which have proved to be effective in the US could also be used in the EU to support innovation in the capital markets, by providing relief from certain rules until they are clarified or amended.

A second industry representative was in favour of working towards a single supervision of EU capital markets. The current fragmentation between a small group of countries with large capital markets and regular IPOs where national competent authorities (NCAs) have the necessary competences to handle the supervision of market activities and many smaller capital markets where the NCAs do not have this experience and level of competence required, is not conducive to the further development of the EU capital market. Below a certain level of IPO and trading activity, it is difficult to maintain a sufficient level of expertise. Consolidating supervision at EU level would ensure further consistency in the level of supervision and create real integration in decision-making, particularly for cross border activities.

An official added that progress towards more coordinated supervision at EU level will help to strengthen trust and confidence in the single market and ensure a level playing field. These are important factors in the development of EU capital markets.

An official agreed that the possibility of implementing a similar type of set-up as in the banking sector needs to be considered. In this set-up the supervision of the main banks operating in the EU is coordinated at the EU level through the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM).

The Chair acknowledged the comments made about the different levels of maturity and development of EU capital markets and the challenge this creates in terms of supervision. However, the argument also works the other way around. Some local authorities supervising the larger and more sophisticated European capital markets may be reluctant to delegate their powers to a central supervisory authority that may not have the same degree of specialisation or level of staffing.

A regulator stated that ESMA, with all the NCAs, is trying to foster effective supervisory convergence in the way EU rules are interpreted. It is not enough to just have the same rules; they need to be implemented on the ground in a consistent way. A great deal of progress has been made in that regard with the support of ESMA.

Answering a question from the Chair about whether a harmonised rulebook can be achieved without a single supervisor, the regulator observed that that depends on the topics in question. Decisions should be made case by case. Some issues should be addressed directly at the EU level and some are better addressed at the national level. With respect to credit rating agencies for example, there is one set of rules, one interpretation of the rules and direct supervision by ESMA. In other areas, for example retail markets, a different approach may be needed. When there is investor detriment, investors will naturally turn to the national supervisor for mediation or redress. There is a need for proximity in those direct retail situations. Coordination processes are in place to develop a consistent approach with common supervisory actions, agreed between ESMA and the NCAs. Consultations are organised in the different national markets and a common guidance is developed based on the outcome. It is a relatively lengthy process by this type of coordination allows the achievement of a convergent approach.

The regulator concurred with some previous comments that further progress could be made in terms of agility in responding to market developments. Currently, amending or updating certain requirements in the framework requires revising the ESMA regulation, which can take many years due to lengthy legislative processes. Some of the issues raised by the application of existing rules could be handled more effectively at the supervisory level with no-action letters issued by the European Supervisory Authorities (ESAs). A no action letter is a legally sound tool that can be used to inform the Commission of the need to suspend the application of a flawed provision until it is fixed, confirming to the market that it can opt not to apply or to delay the application of this rule. This could be useful for addressing some issues raised by the MiFIR regulation for example, such as being able to lift the derivatives trading obligation (DTO) in certain circumstances. ESMA can release statements at present, but these are not legally binding. Similarly, the ESAs could be entrusted with reflecting evolutions in reporting and data requirements, when technical changes must be made. This could be done more quickly at the supervisory level, rather than going through the whole political process.

3.2 Improving the legislative process with a competitiveness test

An official suggested that a competitiveness check should be introduced in the EU legislative process to verify the impact that new regulations may have on the competitiveness of EU markets and EU-based actors, such as banks, asset managers and market infrastructures. A systematic check would help to ensure that the framework supports greater competitiveness over time.

An industry representative was favourable to a competitiveness test, but observed that it needs to conducted on the final legislation. The Commission already performs an impact assessment before legislative proposals are published. That type of assessment is useful, but there are so many subsequent changes made to the legislation throughout the trialogue process that the final outcome is often quite different from the initial proposal. The Commission should perform, as an input to the trialogue process a second, possibly shorter, impact assessment on the expected benefits and impacts of the final legislation for EU markets and players. The Council and the Parliament would then be aware of the implications of changes proposed to the legislative proposal before it is finalized. This would help to avoid unwanted consequences of legislations notably in terms of competitiveness.

3.3 A more ambitious approach to the integration of EU capital markets

An official stated that the upcoming Commission should forego the current piecemeal approach to the CMU initiative and instead opt for a 'big bang' approach aiming to implement a single capital market. That would make it easier to communicate the ambition of the CMU to the general public and build political momentum around the project. Instead of constantly revising the different components of the capital market framework in an incremental way, a more fundamental review should be launched. That would also allow to better take into account the impacts of technology, which are significant.

An industry representative stated that decisive progress on the CMU will not be possible without identifying priorities for the greater good, likely to drive sufficient political support. Otherwise, CMU will likely remain a series of technical initiatives that will progress incrementally. Achieving the ambition of creating a common European capital market with the CMU may require concentrating operational or supervisory activities in certain financial centres and possibly conducting certain activities at the EU level. These types of choices were made with European monetary union and the Schengen agreement and the same should be done for CMU.

An official noted that lessons can also be drawn for the best practices that exist in the EU for channelling savings to the capital market and funding innovation, such as what can be observed in Sweden.

3.4 Better taking into account the role of different players in the capital market ecosystem

An industry representative stated that banks can play a key role in the development of EU capital markets. Wholesale banking is quite integrated in the European Union and acts as a powerful access point to capital for issuers and investors, channelling the capital from pools of capital that want to invest to corporates that need the investment. These flows can be intermediated on a pan-European basis by these wholesale banks. This illustrates the connection between the CMU and Banking Union initiatives.

A second industry representative suggested that the characteristics of different types of players must be better considered in the financial framework and particularly those providing innovative services, as this can contribute to fostering the CMU. When developing prudential rules for investment firms for example, policy-makers set out to create a bespoke regime for a diversity of market participants. However, this resulted instead in a one-size-fits-all application of banking rules to firms with no banking activities.

An official added that is it important to ensure that all the necessary actors needed to provide key activities for the CMU are available. In the clearing space for example, it must be ensured that there is sufficient clearing capacity in the EU and that EU clearing members are able to provide the services needed, notably in times of market stress. This issue is currently being discussed in the context of the on-going EMIR review. This is also true in the asset management sector, where excessive delegation to investment service providers based outside the EU may be detrimental.