CAPITAL MARKETS GROWTH: IMPACT FROM CMU

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Chair - European Securities and Markets Authority (ESMA)

It's time to mobilise our CMU ambitions

30 years on from the creation of the single market in Europe, the value of better integrated markets is evident across all aspects of our everyday lives. Taking this a step further, the Capital Markets Union plan launched in 2015 was intended to further unlock the potential of financial markets for the benefit of European citizens and businesses, in a way to truly recognise the free movement of capital.

It is often said that the CMU plan has not yet delivered on its goal of improving the flow of investments and savings across the EU. While there is certainly much more to do, it would be remiss not to acknowledge the successful milestones in this project over recent years, which has led to more harmonised regulatory regimes and more convergent supervision.

Some important initiatives to push forward the CMU ambition have recently been taken. The European single access point, which will soon open up cheaper and simpler access to company information for investors, and the consolidated tape, aiming to provide real time transaction data to investors, are just two examples. Political agreement reached on key files in 2023, such as MiFID/MiFIR, AIFMD and the CSDR, also denotes essential improvements to crucial parts of our regulatory framework for EU capital markets. Discussions on other files such the Listings Act are also proceeding at pace, with hope to finalise it in the current legislative cycle.

Block by block, a true CMU is being shaped. As each action in the 2020 Action Plan is ticked and the most recently adopted components become embedded in practice, we can expect to see tangible results. However, we must remember that building strong and deep capital markets is not just about adjusting our existing single rulebook as necessary, but it is also about being best in class in meeting new challenges and opportunities. This is particularly important in the context of the green and digital transitions, where the EU is building safe and suitable regimes to foster growth, and position Europe well, in these areas.

As the CMU regulatory framework progresses, we must turn our attention to the next frontier – mobilisation of all forces. This means mobilising companies, investors, and other market participants to fully benefit from EU capital markets, especially in Member States where capital markets have historically been less developed. The Retail Investment Strategy marks one important step in embarking on this phase, as it seeks to empower all citizens to safely participate in EU capital markets.

On the flip side, it is equally important that we foster the right conditions for companies, in particular SMEs, to attain financing from the market as an alternative to bank funding.

Nonetheless, mobilisation of all forces also means better cooperation and a more common ambition, going beyond financial regulation, amongst the political decision makers at national and EU level. A lot of the control for developing EU capital markets remain in the hands of national governments. Until now, depending on the urgency and history of different Member States with regards to their capital markets, we have seen varying levels of success. For example, Sweden is often cited as a European success story in this regard, with a stock market capitalisation of 227% at the end of 2021 (versus 81% for the EU27). They have achieved this success by creating an appropriate ecosystem that supports start-ups, embraces a deeper equity culture, incorporates balanced tax incentives, and remains underpinned by strong supervision. Other countries like Denmark and the Netherlands also have some success in this regard, especially when it comes to mobilising national and private pension schemes to embrace domestic equity investment.

We must turn our attention to the next frontier – mobilisation of all forces.

While it is important to recognise the value of our diverse national markets in the EU and learn from each other about what domestic measures have contributed to success or not, it is not enough to consider this our end game. Member States need to reorientate their focus from being competitive against one another to building an integrated capital market that can be collectively competitive towards the rest of the world.

Mobilisation towards a genuine strong, single EU capital market that is attractive to European and international investors and allows EU companies to find funding and growth opportunities requires a further push to break down remaining barriers.

ESMA remains committed to this vision. We will continue to work with the ESMA Board members to do what we can to make this true single European capital market a reality.

MARIE-ANNE BARBAT-LAYANI

Chair - Autorité des Marchés Financiers (AMF)

European supervision remains the missing piece to complete a true CMU

The past year was marked by a number of economic and political challenges, from the war in Ukraine, to the resurgence of inflation and the end of a decade of low interest rates. Financial markets experienced high volatility, and a significant fall both in equity markets and in bond markets, and the crypto-asset universe saw its first crises. In a difficult global context, the need for the European Union to develop autonomous and competitive financial markets, to enhance access to market financing for companies, to support the EU economy in the long run and to improve its resilience against future crisis remains necessary.

An essential milestone in this perspective, the Capital Markets Union must be completed. It is the key to create a true Single Market in financial services that provides businesses with a greater choice of funding, offers new opportunities for investors in a protective environment and makes the financial system more resilient. We are now at a stage where effective delivery becomes critical for the credibility of the whole process, and for the EU to compete and lead in international capital markets.

Beyond the sectorial proposals in the CMU package that are currently being negotiated and will have to be implemented, there is still a strong need to enhance European supervision and support supervisory convergence across jurisdictions. In this field, in spite of the persistent political resistance to more centralized supervision, we must address the needs of investors and financial market players for more coherent treatment across Member States.

Ensuring more harmonized supervisory practices on the ground is crucial for pan-European players that have a cross-border reach and need a common supervisory stance, as well as for investors, in particular retail, who deserve the same level of protection all across the Union. The EU capital market needs a harmonised and unified supervision that ensures a level playing field for all market players and eliminates arbitrage opportunities.

In this respect, and a minima, the functioning of supervision in the context of cross-border activities within the EU needs to be strengthened, even more so as digitalization grows. Indeed, a number of shortcomings have been observed in recent years by ESMA and NCAs in the supervision of cross-border provision of financial services to retail within the Single Market, at the home NCA level. A new balance of responsibilities has therefore to be considered, while retaining the full benefits of the European passport. Concretely, the EU supervisory framework should be reviewed to provide broader abilities for host NCAs to effectively exercise supervisory powers where financial firms undertake meaningful activity in their jurisdiction - as well as an effective system for the exchange of relevant information between authorities.

By exception, host supervisors and ESAs should be allowed to intervene in a timely fashion in case of serious risks to investor protection and the proper functioning of markets. And ultimately, the principle whereby an investment firm should provide at least a part of its services in the country where it is authorised should be clarified and enforced, to avoid any regulatory forum-shopping undermining the Single Market.

On another front, more convergence could also be achieved by ensuring further hamonisation in the implementation of EU legislation. For instance, the EU should complete the European authorities' toolbox, and equip them with the power to issue so called no action letters as it exists in other jurisdictions. The EU needs the flexibility and legal tools to avoid the deadlocks which may occur where it appears that a legislative requirement cannot be complied with, in exceptional circumstances; or when a coordinated approach with third country authorities proves necessary. This is essential for the market as a whole, and to put the EU on an equal footing with third countries.

Supervision in the context of cross-border activities within the EU needs to be strengthened.

Beyond completing a well-functioning Single Market for financial services and protecting retail investors in the context of the CMU, two other major priorities must be pursued at EU level going forward. As the finance industry and investment behaviours continue to evolve, we should continue to promote more sustainable finance, by developing and clarifying regulations to ensure the rules' consistency. And pursue the thinking on innovation for the construction of an appropriate regulatory framework on subjects requiring it, such as Decentralised Finance, open finance and artificial intelligence.

JOS DIJSSELHOF
Chief Executive Officer - SIX Group

CMU: accelerating progress toward financial integration and economic growth

The Capital Markets Union (CMU) 2020 Action Plan sets forth ambitious goals to enhance integration and efficiency within the European Union's financial markets. It addresses central issues such as providing access to equity for SMEs, creating safer markets for individuals to invest in the long term, and integrating fragmented markets into a genuine single one. The aim is to create the preconditions for ensuring the long-term financing of European industry in all its forms and to support major European projects, particularly in the areas of digitalization (Digital Agenda) and sustainability (Green New Deal).

The EU's efforts to monitor the progress of the CMU (Capital Markets Union) through key indicators have shown slow advancement since the program's initiation in 2015. Notable points from the monitoring report ("Monitoring Progress towards CMU: a toolkit of indicators") include:

1. **Market Funding Ratio:** Non-financial companies tend to finance themselves today at a slightly higher percentage with capital market instruments instead of bank lending.
2. **Retail Investments:** Household investments have decreased significantly since 2015, with a slight recovery in the last two years, despite a general higher savings rate during the Covid crisis (offset again by the restrains caused by the soaring inflation). Most European countries still lag behind the investment rates we see in the US.
3. **Home Bias Indicator:** There has been some improvement in international investment within the EU, with an increase in cross-border investment.

The above-mentioned indicators are examples from a list out of 30 indicators deriving from the EU's actions. They give an idea of the variety of actions taken by the EU. However, this has too often led to a focus on technical details, often at the expense of addressing larger structural issues. In order to accelerate the CMU's developments and to also make listing in Europe more attractive compared to the US, and potentially also Asia, this needs to change!

In short, while the EU has taken various actions to promote CMU, progress has been slow. To achieve the desired results, a shift towards addressing broader structural challenges is necessary.

Financial market infrastructures (FMIs) play a pivotal role in the efficient and robust functioning of capital markets and in accelerating their development. By strengthening FMIs, the EU can bolster investor confidence, promote liquidity, increase transparency, and reduce risks within its capital markets. It will be able to address the needs of various market participants, including small and medium-sized enterprises (SMEs), start-ups, and investors. Simplifying capital access, improving transparency, and reducing administrative burdens will improve the access to funding and encourage cross-border investments. In addition to the aforementioned investments by institutional and retail investors in Europe, global capital is required to raise the funds necessary to implement the European Union's major projects in the area of digitalization and sustainability. Only well-functioning European wide capital markets - including the UK and Switzerland - along with attractive long-term projects, can ensure this influx.

To accomplish the CMU's ambitious goal of creating advanced capital markets, it is important to focus on strengthening FMIs and implementing comprehensive reforms. Legislators and regulators need to embrace necessary changes and facilitate regulatory harmonization, streamlined procedures, and alignment of national rules are essential steps to foster the development of the CMU.

Important examples of overdue measures include efficient tax rules that do not favor one type of capital over another and allow for easy settlement even across national and European borders, or insolvency rules that ensure the same understanding and legal certainty across the EU. Another key issue is to establish a true level playing field between different types of trading venues such as stock exchanges, Multilateral Trading Facilities, and Systematic Internalizers. To realize the CMU's full potential, these issues must be tackled head-on.

It is important to focus on strengthening FMIs and implementing comprehensive reforms.

In conclusion, by leveraging the capabilities of an FMI by creating an adequate regulatory framework, we can make our capital markets significantly more attractive compared to the US and other regions. This would provide our industry with the tools necessary to remain competitive at the global level, and thus reducing the reasons for European issuers to raise capital abroad. It is important that CMU measures are streamlined to reduce their complexity, enhance harmonization, and accelerate the speed of implementation.

TAREK TRANBERG
Head of Government Relations, Europe - Optiver

More is needed to get EU capital markets back on track

Looking ahead to the next legislative mandate after the European Parliament elections in 2024, two pieces of legislation strike us as particularly critical. Both offer policymakers the opportunity to make powerful progress toward the goals of the Capital Markets Union (CMU). One is the prudential regime for investment firms (IFR/IFD), and the other is MiFID II. It's critical that in reviewing these two frameworks policymakers consider Europe's capital markets holistically in a way that encourages (safe) growth and promotes a diversity of market participants.

It is encouraging that the European Commission has asked the EBA and ESMA to deliver technical advice on the IFR/IFD review. We hope that revisions to this framework will ultimately deliver on its original intention, which is to provide a bespoke prudential regime for investment firms appropriate to the diverse nature and range of their activities. What policymakers should avoid is a framework that largely pushes investment firms, especially those that deal on own account and provide liquidity in all major asset classes across EU markets, back into a regulatory category intended for banks.

We are concerned however about recent decisions to treat EU consolidated investment firms differently from non-EU consolidated firms when classifying them under the prudential framework – which works to the disadvantage of EU firms. These latest changes will disincentivise liquidity providers from increasing, or even maintaining, their activity in EU markets. This is not only detrimental to proprietary liquidity providers, but also reinforces the steady trend of declining volumes and liquidity in EU markets. The end result will harm markets' core risk transmission function and create a smaller, more expensive investible universe for end-investors (institutional and retail alike).

We urge policymakers to seize the opportunity for reform here, to ensure that European markets remain an attractive place for existing firms to grow and for new firms to establish themselves.

On the market structure side, after months of tough negotiations, EU policymakers have finally agreed on revisions to MiFID II, marking an important milestone in the CMU project. Policymakers should be applauded in particular for reaching a consensus on the two most divisive topics: a consolidated tape (CT) and payment-for-order-flow (PFOF) rules, which both sit at the heart of the MiFID review and CMU.

With a political agreement now in place, the focus now turns to developing the supporting technical rules and agreeing an implementation timeline. Brussels lawmakers must be vigilant and ensure these next steps do not offer critics a final opportunity to dilute the rules or introduce unnecessary complexity.

We're encouraged the EU has opted for a blanket-wide PFOF ban, especially given the late push for an approach that would have given EU nations the option to permit the practice. Banning market makers from paying for retail flow will remove a potential conflict of interest and impose a level playing field across the EU that should stimulate competition among retail brokers. However, member states that already allow PFOF will be given until June 2026 to phase it out. We hope the grace period does not present an opportunity to reverse or weaken the ban.

The consolidated tape proved to be an even more contentious issue. Negotiators struck a delicate compromise that will see the creation of an anonymised pre-trade feed - showing the best available price for a given security from multiple venues - in addition to a post-trade record of transactions. Given the strong opposition to a pre-trade tape from some corners of the market, getting any form of pre-trade across the line is a laudable achievement. However, there are questions on how useful it is to know the best price for a given stock without knowing where to obtain that price.

EU capital markets need further reform to ensure that they remain attractive for a variety of firms.

Regardless of this progress, important details remain unresolved and offer those philosophically opposed to the CT a chance to further frustrate the process. For example, the approach to revenue sharing and governance of the CT operator will play a large role in determining whether the CT project ultimately succeeds or fails.

Overall, whilst we are closing out the current legislative mandate with some meaningful progress towards CMU, much still remains to be done to make EU markets more attractive for investors and firms alike.

SIMON JANIN
Head of Corporate and Public Affairs - Amundi

The success of CMU is key for the financing of the green and digital transitions

With a level that has been exceeding 12%[1] for the past decade – even above 25% during the Covid-19 pandemic– the Eurozone benefits from one of the world highest saving rates. As the excess of savings over investment surpasses €300 billion each year[2], a better mobilization of this surplus towards productive investment is necessary. And this, in a context where the European Union (EU) needs to achieve both its green and digital transitions. To this aim, the European legislative framework is a key element to ensure that capital markets participants, and notably asset managers, can effectively contribute to channeling more savings towards the financing of the economy.

No doubt that, over the past few years, the European institutions have increasingly realized the importance of private capital to finance these transitions along with the need to ensure more strategic autonomy for the EU. Indeed, transitioning towards a low-carbon economy will go hand in hand with reducing our dependencies on some critical sectors that are key for the transition, which demands production to be built in Europe, to avoid notably supply chain vulnerabilities. And in order to foster more long-term investments that will support European strategic ecosystems, asset managers would benefit from more integrated, deepened and less fragmented capital markets.

Against this background, the European Commission's Action Plan on Capital Markets Union (CMU), published in September 2020, is definitely a step in the right direction. And, as part of this action plan, the development of long-term investment products such as the European Long Term Investment Fund (ELTIF) is a good example of how a pragmatic review can efficiently contribute to the financing of the European economy whilst increasing the engagement in long-term products by retail investors. In this respect, level 2 measures supplementing ELTIF regulation currently being drafted will be key to ensure that the newly adopted level 1 text fulfills its whole potential. In particular, it is essential to make sure that future technical standards are fit for purposes and are not jeopardizing the ability for retail investors to benefit from a larger access to this investment product.

In addition, the upcoming launch of consolidated tapes (CT) in both fixed income and equity markets – as recently agreed by the EU co-legislators – will provide financial markets with more transparency, thus make them more competitive, attractive and resilient for investors. The information provided by the CT will help both retail and professional investors to make appropriate investment decisions and will also contribute to improving best execution and liquidity risk management. A CT will also help reduce market fragmentation, fostering market efficiency and competitiveness. To achieve this, a balanced business framework will have to be found by ensuring free access to CT for retail end-investors while keeping costs at a "reasonable level".

We also fully share the overall objectives of the Retail Investment Strategy, released last May, which aims to make the EU a safer place for citizens to invest in the long term and to encourage participation in capital markets. However, a number of measures suggested by the European Commission in its proposal are very complex and – by focusing only on costs – are just simply missing the target. In particular, the "Value for Money / benchmarks" approach is giving rise to a potential "administrative" price regulation that is very questionable both operationally and as a principle. Conversely, we believe that more attention should be paid on measures that will ensure that retail investors receive streamlined and meaningful information. This would be the most efficient way to help them making their choices and reducing their risk aversion, which remains on average at very high level within the European population (notably if we compare with other jurisdictions, for instance in the US).

Asset managers would definitely benefit from more integrated and less fragmented capital markets.

Lastly, we strongly recommend looking at the granularity and the coherence of all the measures adopted as cumulative effect should not be overlooked. It is also important to stress that a "competitiveness check" should systematically be carried out before the adoption of any EU legislation. And this to ensure that European players benefit from a regulatory framework which preserves their competitiveness and enables them to fully play their role in closing the investment gap, especially in strategic sectors.

1. *See Eurostat, Euroindicators, 40/2023, 5 April 2023.*
2. *See Eurostat, Banque de France, October 2021.*