

FRAGMENTATION IN EU CAPITAL MARKETS



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Building an integrated framework for Europe's capital markets

Reducing fragmentation in European capital markets is a core prerequisite to complete a true Savings and Investments Union. Addressing the structural capital market fragmentation between Member States and removing the related barriers is critical to make sure that progress made on other drivers (like increasing retail investment, reviving securitisation) will deliver their full potential.

The first and perhaps most obvious barrier is the lack of unified, simplified access to capital market financing. Unlike the US, which benefits from a single market with a single rulebook and post-markets infrastructures (Central Securities Depository), Europe's 27 national markets remain largely disconnected. While preserving local access points is essential to support

smaller issuers, our markets need to go even further in harmonising listing rules – a lot has already been done with the listing act – and fostered interoperability between infrastructures, to ensure capital can circulate efficiently across borders.

The second main hindrance we face due to fragmentation is a loss of competitiveness for European financial players, who operate within fragmented regulatory environments and may face duplicative or inconsistent requirements across jurisdictions, translating into higher compliance costs, and operational barriers to scaling activities across the Single Market, notably for fund distribution activities. Fragmentation makes it harder for European financial institutions to reach a critical size and create sufficient synergies, resulting in a weaker competitive position of and a structural disadvantage compared to competitors operating in larger and more unified markets.

Third, reducing fragmentation can help preserve financial stability. This scattered oversight restrains the development of a consistent and coordinated approach to risk management across the EU's capital markets. Unlike the banking sector, where the Single Supervisory Mechanism ensures harmonised prudential supervision and a common understanding of systemic risks, capital markets remain under the fragmented authority of national supervisors, limiting the EU's ability to anticipate and manage cross-border risks and undermining the resilience of the European financial system as a whole.

In order to overcome these barriers and unlock the full funding potential of a truly integrated European capital market, priority should be given to addressing fragmentation in areas with the highest systemic importance and the most significant cross-border activity, where regulatory and operational barriers come with the highest costs.

Our most actionable deliverable remains the integration of supervision, which must be placed at the top of the SIU agenda. A first step would be to bring the most systemically important and cross-border market infrastructures under direct ESMA supervision – CCPs, CSDs and market infrastructures exceeding defined activity thresholds. A similar logic applies to Crypto-Asset Service Providers, whose pan-European

operations generate regulatory arbitrage risks under fragmented national oversight. Beyond infrastructures, we need greater integration for all European players, with potential direct supervision for pan-European asset managers, and at least enhanced collegial mechanisms led by ESMA for others. It is only through such breakthrough, associated with a gradual ESMA governance reform, that we will make progress towards a truly unified and competitive capital market.

In a second stage, reducing the structural fragmentation of Europe's post-market environment will be critical, as the coexistence of 28 national CSDs results in higher transaction and custody costs for investors, with the average cost of settlement in Europe being two to four times higher than in the US, directly undermining the competitiveness of European markets. To break this deadlock, Europe must gradually refocus Target-2 Securities (T2S), which was meant to facilitate cross-border settlement, on its original integration objective and explore its potential extension to CSD functions, which will be critical to reducing the friction and costs that continue to weigh on cross-border investment flows.

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Those reforms, designed to directly curb fragmentation, will require a stronger convergence in legal frameworks. Harmonising insolvency law will allow improving creditor recovery prospects through clearer, single rules on creditor ranking, which will be instrumental in reviving securitisation by providing investors with more predictable treatment in the event of company defaults. At the same time, aligning securities law across member states will be crucial to reducing the high operational costs in both market and post-market environments. Addressing those procedural inconsistencies will help driving up capital flows, enhancing investment capacity, and reinforcing general trust in European markets, supporting the broader ambition of a fully-fledged Savings and Investments Union.



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CMU: building on a solid foundation to enable new technologies in post-trading

In the public debate about fragmentation in the European post-trading market, the figure of 25 different central securities depositories (CSDs) in the European Union often features prominently. This number, though highly suggestive, overlooks the fact that two pan-European company groups hold well over 80% of all assets under custody and are responsible for almost 90% of all CSD settlement activity. All in all, national CSDs and two international CSDs provide efficient services to investors in the EU and beyond.

The fragmentation that we still see in EU capital markets is mainly due to differences in national legislation with regard to securities, tax and insolvency law. While harmonisation here is still lagging behind, various measures have been initiated in recent decades to remove technical hurdles to cross-border European securities settlement. In particular, the TARGET2-Securities settlement platform operated by the Eurosystem since 2015 has helped a great deal in this regard. The launch of

the Eurosystem Collateral Management System (ECMS) in June this year will also advance market standardisation and integration. Supervisory colleges for the supervision of large cross-border corporate groups, including CSDs, are also a useful step.

It is conceivable that the long custody chains that currently exist between issuers and investors, which can include local and global custodian banks and central securities depositories in particular, could be significantly shortened in technical terms through tokenisation. In addition, smart contracts could be used to carry out capital services (such as dividend distributions) more efficiently. By using distributed ledger technology (DLT), both investors and issuers could use a common data repository (single source of truth), which should significantly reduce the need for reconciliation in general and the error rate that occurs during reconciliation. The use of DLT makes atomic settlement possible in principle, i.e. the immediate and simultaneous (final) settlement of both parts of a fully digital securities transaction using a smart contract.

That being said, to foster the CMU, the immediate focus should be on how existing private and public financial infrastructures can be leveraged to facilitate innovative new technologies in the EU post-trading market. In the longer-term, the build-up of a new financial infrastructure could be advisable. Consequently, the Eurosystem is clustering its work on the use of new technologies for the issuance, trading and settlement of financial instruments, the promotion of tokenisation and the concept of a European single ledger into two different tracks: a short-term track and a long-term track.

**Leverage existing
financial infrastructures
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In 2024, the Eurosystem explored various ways of settling tokenised securities in central bank money. Over a period of six months, it tested three interoperability solutions that combine DLT with the Eurosystem's conventional payment transactions. More than 60 financial institutions were involved in these experiments and trials in real central bank money. Going forward, the Eurosystem has decided to quickly develop a short-term solution which is interoperable

with existing infrastructures, and in parallel, to look into a more long-term integrated solution.

The EU DLT Pilot Regime introduced in 2023 is another crucial building block for enabling novel technologies in trading and post-trading to grow. The Pilot Regime provides a regulatory sandbox for trading and settlement of transactions in tokenised assets that qualify as financial instruments. What is needed, however, is to discuss realistic ways to transform this sandbox regime into a permanent one that is going to enable market participants in the EU to fully realise the benefits of tokenisation.

Digitalisation thus offers new opportunities to strengthen the efficiency of the European financial markets – including the post-trading system – and to overcome national financial market boundaries. The potential here is far from exhausted. To foster the development and adoption of promising new technologies in securities markets, such as tokenisation, it is crucial that policymakers, regulators, central banks, and the financial industry cooperate closely. The harmonisation of different national securities, tax and insolvency laws is the necessary but lengthy and laborious work that will reduce fragmentation in EU post-trading significantly in the long term. In the meantime, we should focus on leveraging existing financial infrastructures to facilitate innovative technologies in EU post-trading.



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Secrets to the SIU's success: Unification, consolidation, and integration

The Savings and Investments Union represents a generational opportunity to unlock the true and full potential of EU capital markets. Its success is dependent on addressing fragmentation through (i) unifying the transparency framework, (ii) consolidating post-trade infrastructure, and (iii) integrating the trading venue landscape. These initiatives will deepen and strengthen capital markets, make the EU a more attractive investment destination for both domestic and international investors, and enhance and optimize the allocation of capital to the real economy.

Unifying the transparency framework

A unified and harmonized framework for pre- and post-trade transparency is a critical first step towards addressing fragmentation in EU capital markets. Fortunately, the EU has already embarked on this journey, with consolidated tapes expected to be authorized by ESMA in 2025 for bonds and in 2026 for equities. These tapes – together with necessary reforms to the deferral framework to increase the quality and timeliness of post-trade data, particularly in the bond and derivatives markets – will for the

first time provide a truly unified and holistic view of trading activity in the EU. First-hand market experience and a wide body of in-depth empirical research illustrate that such improvements in transparency enhance market quality, deepen liquidity, improve outcomes for investors, increase competition and make markets more resilient.

Consolidating post-trade infrastructure

Further consolidation and rationalization of post-trade infrastructure will enhance market efficiency through economies of scale, operational simplicity, and lower overhead costs. As the Draghi Report observed, *“in Europe there are more than 20 CCPs and CSDs for equities alone, and different platforms use the services of different CCPs or CSDs. As a result, cross-border transactions are more complex and costlier than domestic transactions, hindering multimarket trading”*. Of course, as the Letta Report also importantly notes, this must be done in a manner that ensures *“fair and open access for all actors, proper governance and sufficient incentives for innovation.”* Consolidation does not mean there is a one-size fits all solution – rather, the post-trade landscape should be optimized for each asset class. In the US, for example, there is a single CCP for each of equities and options, two new CCP entrants primed to bring greater choice and competition to the US Treasuries market, and two CCPs serving the interest rate swap market.

Success depends on addressing fragmentation in trading, clearing, settlement and transparency.

Integrating the trading venue landscape

Integrating the trading venue landscape is a third critical step toward addressing fragmentation. Markets participants welcome choice and competition among trading venues, so the presence of multiple exchanges and MTFs in and of itself is not a negative. However, as ESMA correctly observed *“...despite the acquisition of national stock exchanges by EU wide groups in recent years, this has not led to a unification of the operated stock exchanges. Exchanges continue to operate at the national level and without a cross-border order book, leading to a continued fragmentation of liquidity.”*

Indeed, EU exchanges do not compete with each other, neither for primary

listings (where the only real competition is between a national exchange and non-EU exchanges) nor for secondary trading (where the only real competition is between a national exchange and pan-European MTFs and SIs). This fragments liquidity, deprives the EU markets of the benefits of choice and competition, impairs market resiliency during exchange outages, and forestalls any true consolidation or rationalization among exchanges.

By contrast, in the US, while there are over 15 equity exchanges and 30 alternative trading systems, (i) there are two primary listing exchanges that compete vigorously with each other for listings, and (ii) irrespective of the listing exchange, shares can and do trade on any and all of the different exchanges and ATSS. This arrangement represents true choice and competition among trading venues and enhances market resiliency, as the high degree of substitutability means that an outage at any one venue does not impact overall trading.

Coordinating with the UK

Continued alignment and coordination between the EU and UK markets remains essential. We welcome the EU's new “competitiveness” mandate, but it is not zero sum game – the EU and UK markets can and should bolster each other. Market participants' ability to efficiently navigate European markets increases their willingness to commit capital to the region as a whole. The recent announcements that the EU and UK will both shorten their settlement cycles to T+1 in October 2027 is a positive step in this regard. The upcoming tender process for CTPs in the bond market provides another opportunity. Notwithstanding variations in the transparency framework between the EU and UK, the same CTP could effectively consolidate and distribute data across both markets.



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Together we can be strong: Reducing fragmentation to unleash the SIU potential

By transforming the Capital Markets Union into a Savings and Investments Union (SIU), the EU is currently preparing major changes to boost growth, competitiveness and attractiveness. Against the background of profound changes in geopolitical realities, enormous challenges around economic growth and huge financing needs, time has come to fundamentally reshape the EU's policy-approach and strategy.

Reducing the high level of fragmentation across the EU's capital markets remains a key ingredient to fully unleash the potential of the single market. In that context it is a welcome development to observe an increasing recognition around the need to support market-driven consolidation and a broader reflection as to how existing single market barriers can be tackled.

Part of the exercise also concerns the EU's M&A rules, where the intended review of the existing framework can make a significant positive contribution in order to allow for more scale and to support the development of

EU champions by boosting global competitiveness. This does not only include a reflection around the definition of the most relevant market at product and geographical level. But it should also come with additional work around efficiency defenses and a true level playing field with other key jurisdictions.

However, the EU should simultaneously continue to address various single market barriers to ensure that cross-border business realities are being enhanced with an improved competitive operating landscape for products and services that remains conducive to growth. First steps have been taken, such as the FASTER initiative streamlining processes of withholding taxes. But we need to go much further.

Especially the EU's post-trade environment would benefit from a reduction of existing national legal barriers impeding the provision of effective cross-border services. An optional and voluntary 28th regime would support, ideally combining elements of securities, insolvency and corporate law – starting for example in the field of digital emission of securities. Other crucial levers include a review of settlement internalization realities and a general leveraging of the ECB's Target2Securities.

Yet, we should also remain ambitious on the trading landscape where the MiFID framework has contributed to fragmentation realities, diverting liquidity from lit regulated markets to dark-trading and off-exchange venues, thereby not only reducing transparency and negatively impacting price formation – but also coming with profound implications for the ecosystem around primary markets and the EU's

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attractiveness as a business location.

With over 500 trading and execution venues across all asset classes and more than 200 in equities alone, the EU's trading market structure is the most fragmented among developed countries. The proliferation of alternative execution venues, predominantly SIs and dark pools but including persistent OTC practices, paired with overly complex waiver, transparency and

deferral regimes, require a profound policy reflection on how the EU's future market structure can truly support the political objectives of deeper liquidity pools, growth, global competitiveness and a strategic autonomy.

Finally, we should not forget that a successful SIU will not only depend on an enhanced reality concerning the fragmentation topic, but also on the EU's general ability to deepen liquidity pools by mobilizing and transforming private savings into productive investments. Currently, over €33 trillion of European savings are held in currency and deposits across the EU – a huge untapped resource for the SIU.

All EU citizens should have the opportunity to invest via an EU savings and investments account that is paired with fiscal incentives. In addition, the EU's pension funds and institutional investors should increase their equity and risk capital investments, where it is a positive signal that key frameworks, such as Solvency II or IORP, are being looked at. And: We need to continue the journey on the famous PEPP to guarantee a meaningful transformation towards a capital markets oriented set-up (e.g. "EU 401k").

A visionary approach is essential – but pragmatism is needed in light of global dynamics. Therefore, we should learn from successful case studies in Member States and build on them when designing the future of the EU. Sweden, for example, has developed a strong retail investment culture through financial literacy programs, government tax incentivized and well-developed savings and investment vehicles – leading to outstanding results.

Examples like these underpin why we should be bullish: The EU has a solid ground to build on and a history of delivering key reforms in challenging times. Let's cut the noise and get it done!



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We can build it, but will they come?

It has been ten years since the announcement of the CMU project and yet progress has been underwhelming.

Commentators tend to bemoan the continuing fragmentation of the EU capital markets, but our view is that this should not necessarily be the primary concern. We can develop a consolidated market, but we would still be missing the capital, which is, de facto, what feeds the market.

Some fear that the European Union will be bereft of high-growth companies where they choose the United States as a listing location and ultimately export themselves there. This fear is overly simplistic: investors are drawn to growth stories and seek to benefit from them. What is critical is that they have the ability to invest local savings into successful companies.

The EU has already proven how this can work. Sweden alone is estimated to have contributed far more to the overall growth of EU capital markets in the last decade than would be expected given its small EU GDP share. Sweden and other EU countries have also unleashed a huge amount of investment potential by mobilising retirement savings. However, these countries tend to be the exception and not the rule. Challenging current retirement provisions and

levels of retirement savings may lead to uncomfortable conversations, but the benefits in terms of increased investment capacity and more secure retirements mean they are worth taking on.

Each country has different needs, but all require a single-minded focus on harnessing private savings as a capital base for European industry and its need to innovate.

In Spain, an experimental proposal for capital markets-oriented improvements under the “EU Competitiveness Lab” programme has garnered support from several other EU countries. The initiative would see these EU countries implement new innovative projects in a controlled fashion, fostering European competitiveness while opening up the door for the Commission to extend projects to the rest of the EU, if tested successfully. An example of this is Youth Savings and Investment accounts, to bring young Europeans closer to the capital markets.

It is only by testing new things that we will get new results. The political courage to join such attempts is what is truly required at this juncture, and to accept that a certain amount of “testing and learning” is far more valuable than grand pronouncements.

This political direction needs to be firmly implanted in every level of EU policy making. The need for simpler regulation via the Omnibuses proposed by the Commission must be prioritised by the co-legislators, to ensure that they are in effect quickly and are supported by simplified level 2 rules, guidance and on into supervisory practices in national competent authorities. Courage is needed here too: too much protesting that “simplification doesn’t mean deregulation” entails the risk that elements which have proved to be of no value simply survive in a watered down version, rather than being eliminated.

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to feed the market.**

If we effectively address these issues, it may follow that fragmentation reduces, but that itself does not need to be the primary aim. Calling on individual and institutional investors to invest more in European capital markets will only be effective if they can do so with ease and

at competitive cost. There will be little appetite to invest in European markets if investors believe that material time and cost will be spent on interacting with an inefficient system.

While the EU has recently taken positive steps towards the introduction of a consolidated tape for bonds and equities, which will soon further enhance price transparency across EU markets, a complex and costly post-trade landscape remains in place that embeds major costs and inefficiencies. It may be that we, as players in the market, are most aware of these costs and inefficiencies – but it is the end investor that ultimately pays them by the resulting lower returns.

‘Top-down’ efforts at the EU level to harmonise regulation and integrate the post-trade environment can help address these legal barriers. Technological advancement and the move to T+1 provides further opportunity to reimagine how post-trade works in the EU.

However, for our capital markets to flourish, it is really the ‘bottom-up’ reforms at member state level that will have the biggest impact. Investment is a choice, and many of the levers determining whether that choice is made remain at a national level – pension system design, taxation, education systems. Targeted changes in these areas, perhaps pursued jointly with fellow countries and subsequently endorsed by the European Commission, have the potential to encourage greater equity ownership by EU populations and stimulate the development of promising companies and industries. The Draghi entreaty to “do something” needs to start here: instead of waiting for Europe to provide the answer, taking action at the Member State level to do more to channel savings into investment must become a core pursuit of our region’s governments.



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Reducing barriers by building integrated, efficient, and competitive markets

European markets have made great strides in recent decades to increase competition and lower costs for investors. MiFID/R brought competition to equities trading and clearing, and EMIR further developed open access and interoperability for CCPs. These efforts have lowered costs, materially improved netting, and reduced cross-border barriers. Today, a market participant can access all of Europe by connecting to a single pan-European equities exchange or clearinghouse in a way that was inconceivable 20 years ago. As we explore ways to integrate our markets further, we must not let concerns around fragmentation reverse decades of progress to lower barriers and integrate our markets. The pan-European competitive model will deliver even more benefits for Europe if we fully embrace it by removing those barriers that remain.

How do we remove barriers? **By embracing competition, innovation, and user choice.** This fundamental principle is essential to advancing integration and efficiency. Uncompetitive vertical silos are barriers to integration and choice, perpetuating fragmentation of liquidity and capital. Competition, innovation, and customer choice drive integration

and efficiency by reducing suboptimal, high-cost services. We must avoid policies disguised as ‘fragmentation reduction’ that maintain uncompetitive silos, reduce choice, and sever Pan-European networks. To build an SIU that improves outcomes, we must prioritise supporting an ecosystem that fosters competition through openness and interoperability.

How can policymakers support financial market infrastructures to drive integration and efficiency? **By supporting exchange innovation, expanding interoperability in equities clearing, and removing barriers to open access for clearing of equity options.** Embracing exchange innovation is vital as it ensures individual exchanges succeed only as a result of improving markets and solving clients’ problems rather than as a result of national bias or inertia. With respect to equities clearing, interoperability has driven substantial operational and capital efficiencies through risk-netting and settlement compression. We must extend interoperability in equities clearing to all European cash equities markets, including by mandating large exchanges adopt full interoperability.

Fundamentally, interoperability means a market participant can choose to connect to a single clearinghouse, providing optimal choice and efficiency at the same time. This is the destination we should pursue across markets, but we will not get there through forced consolidation or constrained choice. We will get there through multiple exchanges, clearinghouses and other providers innovating, investing and competing vigorously to solve problems for clients and investors while supporting fully interoperable links that enable market participants to truly choose the provider that solves their needs.

**The SIU will succeed
if we empower
investors, support
innovation and expand
interoperable links.**

MiFIR’s open access requirements have driven competition and integration in equities clearing, and similar efforts should be made for equity options. While the current cash equities interoperability model may not be the solution for equity options clearing in the same way as it was for equities, we must be open to commercial solutions in clearing that can drive further integration. Policymakers can support

this effort by supporting mechanisms that achieve open access in equity options clearing.

How can we grow the pie? **By funding our companies and delivering for retail investors.** Ensuring public markets are attractive to new and innovative companies is vital to ensure those companies can easily access capital in their early-stage growth periods. Listings and prospectus rules are an important area of focus, but we must build and support our companies at every stage. The startup and scale-up strategy will be critical, but the pre-IPO strategy will not succeed if we don’t also have robust, dynamic and deeply liquid public markets. In order to support the growth of public markets we must foster a culture that supports and encourages retail investors.

Turning savers into investors will yield substantial dividends, including greater funding for companies, increased liquidity, and higher valuations. Near-term, the Retail Investment Strategy must be consistent with the overall objective to attract retail. Longer term, a pan-European investment account with preferential tax treatment will certainly incentivise contributions, but tax incentives alone are not sufficient. A successful SIU means billions of euros in additional risk capital invested in the market. We must ensure investors have access to available tools to manage this risk. SIU accounts must allow for transparent exchange-traded options and futures to enable equity portfolio risks to be appropriately managed.

We must also consider whether additional market structure changes are necessary to support the future growth of retail. In the US, almost all retail equities trading occurs off-exchange – an unhealthy dynamic caused by a lack of a level playing field between exchanges and off-exchange platforms, which weakens price formation. To benefit investors, this should be avoided in the EU, and it may be necessary to encourage retail orders to be traded on exchange.