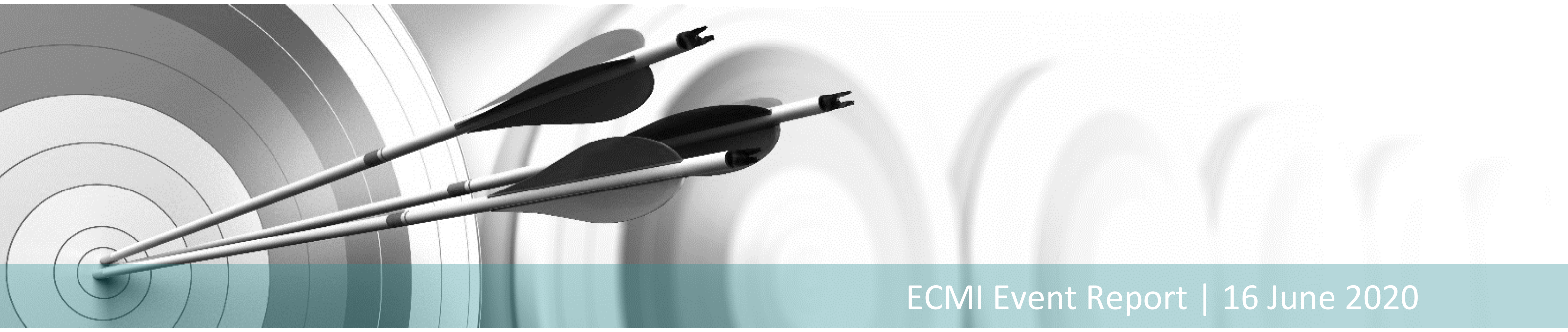

Capital Markets Union: entering a new phase?

Apostolos Thomadakis*

Soon after the work of the Next CMU High-Level Group, the EU Commission set up its own High-Level Forum (HLF) to discuss the continuation of CMU. The HLF published its final report on June 10th. It is expected that the Covid-19 crisis will sharpen focus on the real economy (SMEs and households) and the role of market finance in general, as recovery and resilience strategies take centre stage. This CEPS-ECMI webinar discussed how the EU could come closer to creating one single market for savings, investments and raising capital for young and innovative firms. It also explored the measures and supervisory set-up that will enable cross-border financial activity to scale up.

Speakers:

Thomas Wieser, Chair, CMU High-Level Forum & former Secretary General of Eurogroup
Carmine Di Noia, Commissioner, CONSOB (Italian Securities and Exchange Commission) & Chair, Committee for Economic and Markets Analysis, ESMA
Niamh Moloney, Professor of Financial Markets Law, London School of Economics

Moderated by **Fabrice Demarigny**, Chair of the Next CMU High-Level Group & Global Head of Financial Advisory Services, Mazars & Chair of the ECMI Board

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The report is not a transcript of the speakers' interventions; rather, it should be understood as an interpretation of their views by the author.

Summary

Progress on the Capital Markets Union (CMU) project has so far been limited.[1] Acknowledging that, in November 2019 the European Commission (EC) launched the HLF with the mandate to propose targeted actions that would advance and support the creation of a CMU. The HLF-report offers a set of granular recommendations for what remains to be done so that capital markets become more instrumental to the financing of the EU's real economy, facilitating the cross-border flow of capital.

The urgent and timing of the HLF report is critical. For the second time in just over a decade banks are coming under pressure, the lending process has been compromised, and there is a need for capital markets to pick up the slack. The HLF report places strong emphasis on strengthening national capital markets – a fundamental component of CMU – to build market finance within the single market.

Even if all 17 recommendations were to be implemented in the next five years, it will be very difficult to create a deep single capital market equivalent to that of the US. However, the recommendations would allow Europe to move forward and come considerably closer to its ultimate goal of halting fragmentation and creating a genuine CMU.

The HLF report adopts a holistic approach, focusing on both the supply and demand side, as well as on cross-border infrastructure.

On the supply side, and in order to ease access to finance for young, small and innovative companies, the HLF proposes setting up a European single access point for data (probably by ESMA), where comparable and standardised data will be collected and become available to potential investors, free of charge. The conditions that would allow harmonised data from national administrators to be collected and integrated into one easily accessible centralised point need to be in place. But before that, there should be an agreement on the uniform definitions and standards to be used, as well as on the reporting. There is a huge amount of data floating around Europe, but without easy access to it by market participants and investors, it goes to waste. Of course, the pressing question here is: who should take the initiative on this? Should it be a market infrastructure in a competitive environment (and what incentives are there for private players to jump in), or it should be through public intervention?

On the demand side, aiming to reduce the significant limitations that institutional investors, in particular insurers, face on what they can invest (in terms of equity), the HLF proposes targeted changes to Solvency II (currently under review) that will allow insurance companies to invest in SMEs and midcap businesses. As for retail investors, although their participation in capital markets has increased since the beginning of the Covid-19 crisis and there is growth in capital-protected products, it has not been followed by an increase in financial literacy or in warnings from regulators about market volatility. It is thus important that the HLF focuses on the need to build consumer trust in capital markets and improve the quality and reliability of professional advice. However, there should

[1] Although progress has been achieved on the legislative agenda (in the 2014-19 mandate, an agreement was reached on 12 out of the 13 initiatives put forward by the Commission), there is rather less progress on overcoming fragmentation and creating a genuine CMU.

be a deeper drilling into investor protection supervision, identification of conflicts of interest, and targeted regulation.

Even though most of the recommendations are addressed *prima facie* to the European Commission, national regulators have an important role to play too. One of the reasons why national markets are still largely segmented is the regulatory and administrative barriers currently in place. Focus should therefore be on creating the right environment and providing incentives that would allow member states to cooperate better and abolish such barriers. For example, withholding tax is a major disincentive to cross-border investment, especially for retail investors. For this reason, creating a digitalised system of – more or less – automatic refund of withholding tax, would allow investors to use a single EU system that reduces the cost, length and administrative burden of the refund procedure. But also insolvency law, which remains very much in the domain of individual member states, results in lengthy insolvency procedures that vary significantly across countries (from two years in some countries to up to eight years in others).

Regarding supervision, the HLF highlights the need for more specific supervisory and convergence powers. In the future, there is likely to be more dispersed capital market activity across the EU and different pockets of specialisation.[2] The rationale for enhancing supervisory convergence and moving away from directives and towards regulation is therefore strong. The HLF report highlights and supports the notion of *no action* – the ability of ESAs and ESMA to take no action, waive or suspend action. This type of 'smart regulation' is not about new rules but about suspending and removing rules that do not work (i.e. do not deliver the expected outcome or create divergence). But to achieve that requires a nimble and entrepreneurial way of thinking about regulation.

ESMA's approach during the Covid-19 crisis already goes in this direction; it is using its supervisory convergence tools to effectively adapt supervision to changing needs. For example, ESMA has relaxed, extended, or slightly recast rules so that they work in a crisis context.[3] Therefore, strengthening the ability of the ESAs to engage in waivers and 'no-action activity' could be an ideal form of smart or outcome-oriented regulation.

Having said that, it is important to note that centralised supervision does not necessarily imply one supervisor. In fact, thousands of small asset managers would continue to be supervised at the national level. In the banking union for example, there are 115 centrally supervised banking groups, and thousands of other entities that are supervised indirectly. Similarly, in the CMU there would be large cross-border operating institutions (with a certain risk of spill over) supervised at central level, while all others would remain supervised at national level under the guidance of the authority responsible for the central supervisor. These two forms of supervision are mutually reinforcing. While it may be too early to have only centralised supervision, it may be too late to have only local supervision. Thus, having supervisory convergence with a stronger role for ESMA would accelerate the move towards a genuine CMU.

[2] Financial integration in Europe has gone into reverse since the global financial crisis. Brexit will most probably further aggravate fragmentation, while the Covid-19 crisis risks amplifying cross-country distortions due to competition in product and capital markets.

[3] For example, ESMA relaxed MiFID II call recoding rules, as well as best execution reporting requirements, while it amended the bilateral margin requirements under the European Markets Infrastructure Regulation (EMIR). For a complete list of ESMA's actions during the Covid-19 outbreak see https://www.esma.europa.eu/about-esma/covid-19.

Looking to the future, the creation of a legal and technological basis for digital-age capital markets is necessary, for example, by providing identical legal framework conditions for the use of crypto assets, including digital coins. Instead of embarking on 27 differing national legislations and ending up with a fragmented and probably small market, Europe should act now if it wants to become the leading jurisdiction in the digital era.

With the HLF, Next CMU High-Level Group[4] and various other reports,[5] the Commission now has a very strong base on which to design and realise an ambitious vision of the completion of CMU. The current geopolitical challenges facing Europe (namely, Covid-19 and its aftermath; Brexit; environmental transition; and pension security for future generations) offer an opportunity to swiftly overcome obstacles (both structural and political) to creating a unified EU27 capital market.

However, the HLF's recommendations, although important, should be combined with other dimensions of the CMU. For example, to drive savings to a more sustainable economy, to favour a very competitive financial sector with critical mass, to put down a real industrial digital finance plan that would help create Pan-European platforms, and to promote and support the international role of euro, which is fundamental for a strong, deep and liquid EU capital market.

Last but not least, political leaders have an important role to play in explaining to the population why the integration of European capital markets has a purpose, how savings can be channelled into cross-border investments in a transparent and secure way, why long-term capital is vital for companies, and what are the benefits of living in a more sustainable economy. Perhaps it would have been easier to garner political support if the name of the project had reflected its real objective. Rebranding the CMU project to **Saving and Sustainable Investment Union** would align the name more closely with the policy objective.

[4] See "Savings and Sustainable Investment Union", Next CMU High-Level Group.

[5] See for example, Lannoo, K. and A. Thomadakis (2019), "Rebranding Capital Markets Union: A Market Finance Action Plan", CEPS-ECMI Task Force Report, Centre for European Policy Studies."

European Capital Markets Institute

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