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Mutual funds hold the key to a genuine capital union in Europe

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Not a week goes by without EU policymakers repeating the need for more capital markets financing in Europe. They argue that the huge costs of the green and digital transitions cannot be financed with state funds alone. They are correct — but that's where it stops. Concrete proposals are lacking.

This is because those same policymakers defend national turfs. The Capital Markets Union, launched in 2015 to stimulate the creation of a pan-European market for investment and trading, remains an abstract notion. Although many harmonising measures have been adopted, market development remains very uneven across the continent and has not advanced at all in southern and eastern Europe.

Last year's EUR 75 billion listing of carmaker Porsche is a case in point. This could have been a showcase for the start of an EU-wide IPO market. Instead, it was kept within German borders and with a very low free float.

If the EU wants to build deep and liquid capital markets that rival those of the US, then it is time for policymakers to start killing some sacred cows. They need to take drastic action to increase the amount of investment from European households into the continent's capital markets by making mutual fund markets more attractive.

Today, Europe's fund markets are hopelessly fragmented, resulting in elevated costs and lower take-up. The average fund's size in Europe stands at EUR 300 million, or about a tenth of the average US fund. Fund costs are opaque as well as high, hampering price competition.

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Private equity and venture capital also remain very under-developed in Europe, impacting Europe's competitiveness and driving European success stories such as Spotify or BioNTech to list in the US instead.

Radical reform could enable European fund and capital markets to double in size, with households investing excess deposits more wisely, and maybe also more safely long term. Directing more savings into companies could also help provide for elderly citizens in their retirements — an acute problem in the majority of EU Member States — as well as reducing banks' balance sheets and creating more liquidity in markets.

The EU should prioritise the development of its individual capital markets before attempting to fully unify them. Stronger local capital markets are a precondition to having a more EU-wide capital market. This, however, would require a regulatory framework that is flexible and adaptable. Highly complex and detailed rules may not suit smaller markets. The European Securities and Markets Authority (ESMA) should be allowed to exert more pressure to ensure that the same principles are applied across the bloc, and that mutual recognition is enforced.

But alongside stimulating the development of local markets, the EU should move towards bloc-wide supervision where it is necessary. In the recent proposals for EU-based clearing infrastructure, the European Commission left supervision of its 13 central counterparties decentralised. It ought to have proposed single supervision of such highly systemic and concentrated entities.

EU-wide licensing would also make more sense for capital raising offers across multiple markets, and create a deeper market. Investor protection rules should be mutually recognised to allow for truly pan-European capital raising exercises.

Equally important is to have easily identifiable metrics that will facilitate better monitoring and the assessment of progress towards the objective of creating a deep European capital market and overcoming fragmentation.

Establishing a comprehensive set of key performance indicators on the competitiveness of EU actors, the relative attractiveness of EU capital markets and the efficiency and effectiveness of supervisory structures, is a necessity. A few indicators on the degree of financial integration is not enough. In the same vein, a high-powered group of experts should be required to report on market developments to policymakers on a regular basis.

These matters are also of importance given the concerns about banks' solidity that have re-emerged since the collapse of Silicon Valley Bank in the US and the rescue of Credit Suisse in Switzerland. A deeper and more attractive EU-wide capital market would provide small investors with more choices for their money at lower cost, better growth opportunities for fast growing European companies and result in less volatile markets.

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