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Capital markets union – reboot: a policy discussion on the future of the capital markets union

- Presidency issues note for informal ECOFIN working session Ib

- The aim of this session is to launch a discussion on the Union's priorities in the field of the capital markets union for the next institutional cycle. Ultimately, the aim is to identify and find agreement on a set of practical measures to encourage cross-border integration of the European capital markets, including measures that Member States could implement.

Background

- In September 2015, the EU launched an action plan on building a single market for capital: a capital markets union (CMU). Together with the banking union, the CMU can help to maintain cross-border capital flows and sustain investment in Member States suffering large asymmetric macroeconomic shocks, thereby strengthening the EU economy. The CMU aims to provide more funding sources for business, especially for small and medium-sized enterprises (SMEs) and therefore reduce dependence on bank lending, to increase investment options for retail and institutional investors, and to enhance cross-border investments. The action plan sets out a programme of 33 actions, which aim to establish the building blocks of an integrated capital market in the EU by 2019.
- By the mid-term review of the CMU action plan in June 2017, 20 of the 33 envisaged measures had been completed (10 of them were legislative measures). By spring 2019, political agreement had been found on another 10 legislative proposals. With only a few legislative files still open, the Union has essentially completed its original action plan. Now is the time to assess where this work has taken us and where to go from here.

The state of the CMU

- Of the completed measures in the action plan, some have already started to have an impact, while others are at early stages of being phased in. Some are yet to enter into force. The first steps should be to take stock of the achievements and shortfalls in order to form a clear picture and to identify gaps and the need for further work. The functioning and effectiveness of the rules – both those introduced recently and those

established earlier – should be thoroughly assessed and adjusted if necessary.

- Despite significant progress since 2015, a single and competitive capital market remains more an aspiration than a reality. Regulatory and other barriers still hamper smooth movement of investments and related services. While the number of completed measures is impressive, agreement has in many cases come at the cost of substantial dilution of the level of ambition. A realistic assessment of progress so far will likely conclude that the measures taken so far, even when in full force, will fall short of what is necessary for a complete CMU. A new start – a reboot – for the CMU should be a top priority for this institutional cycle.

A CMU reboot

- Four years of experience have equipped us with a better understanding of the impediments to the CMU and of the legal and political difficulties in addressing those impediments. There is no simple, single solution to unlocking the growth potential in European capital markets. Rather, the solution is likely to come in the form of a combination of measures, legislative and non-legislative. These could include the following:

Barriers originating from national law

- Discrepancies in key pieces of national law – e.g. insolvency, corporate, securities, and tax law – have long been identified as undermining the predictability of the application of the rules and thus acting as a significant barrier to cross-border capital flows. The CMU action plan contained several measures to address those barriers. In practice, national sensitivities, including the complex interlinkages of these laws in the national legal systems, have held back progress. Reducing those barriers remains an important long-term goal. However, many of them extend beyond the competence of the ECOFIN, and progress is only possible with a high level of ownership across the relevant Council formations. The ambition for the next institutional cycle should be based on a realistic feasibility assessment.

Focus on retail clients

- Households and other retail savers are the main source of long-term funding for the European economy. Retail investor engagement is therefore critical for the development of a stronger capital market with deep pools of capital and liquidity. The EU should seek ways to increase the attractiveness of capital markets for its citizens as savers and investors.
- Enabling retail access to smoothly functioning and harmonised capital markets could also play a role in addressing the pressure on pension schemes caused by the EU's demographic challenge. EU households still hold their savings mainly in cash, bank deposits and insurance and pension

products, even though more direct investments in capital markets – e.g. shares and bonds – would, over the long term, generate higher returns.¹

- Financial services for consumers consistently rank among the poorest performing services markets in the EU.² Regarding comparability of different products and services, consumers' trust and expectations, financial services market remains one of the lowest ranking of all the 25 services markets. Comparing and interpreting fees across providers and products can still be very difficult, even for well-informed investors.
- Against this backdrop, sufficient transparency, comparability and disclosure is fundamental for investor confidence. Yet excessive information may obscure rather than help. Transparency rules that are too detailed and complex can make the information difficult to digest for a retail investor. Rules need to be calibrated so as to ensure retail and professional clients each receive appropriate information and protection according to their needs, in an accessible form.
- Financial literacy is a fundamental precondition for building up citizens' capability and confidence to use financial services broadly. Consumers must be able to understand and choose most suitable financial product for themselves. Financial literacy could at its best, facilitate direct investment without high intermediation costs typically charged of retail investors. The Commission and Member States could facilitate sharing of best practices.

Focus on SMEs

- SMEs are the main drivers of the European economy. Bank credit is currently the dominant source for SMEs' external financing. However, especially start-ups and small, innovative companies often require a mix of debt and equity funding or have limited access to bank funding. At the same time, European market places for SMEs are struggling to attract new issuers. In order to contribute to growth in an environment that foster investment, barriers to cross-border growth for young, small and innovative companies should be eliminated. Regulatory requirements should be reviewed to ensure that the burden is not prohibitive for smaller markets and smaller market participants. Targeted and proportionate regulation is needed to ensure an attractive pre-IPO and IPO environment for SMEs.
- There are some indications that MiFID II rules may have reduced the amount and quality of SME research available for investors. Reduced research coverage of SMEs is negatively affecting the liquidity and efficiency of SME markets. Thus, the establishment of a proportionate

¹ Capital Markets Union: progress on building a Single Market for capital for a strong Economic and Monetary Union, European Commission staff working document 2019.

² Consumer Markets Scoreboard: making markets work for consumers, European Commission 2018.

mechanism for research providers is needed in order to address the coverage cap.

Securitisation

- Securitisation has slowly started to recover in Europe. The performance of the new framework for simple, transparent and standardised (STS) securitisation needs to be closely monitored and, if necessary, adjusted to ensure that this mechanism remains safe but also viable and attractive for issuers and investors.

Post-trade

- There remains room for progress in removing legal and operational barriers identified by the report of the European Post Trade Forum in 2017. So far, improvements have been incremental and segmented. Further efforts may be needed to improve the efficiency and interoperability of securities record-keeping and settlement systems, and technological developments must be taken into account. Impediments to cross-border exercise of shareholder rights should be addressed. More efficient withholding-tax collection procedures could also contribute to the attractiveness of cross-border investments.

Digitalisation

- Digitalisation of financial services can open up new avenues for cross-border access for businesses and investors to investments and related services, by reducing barriers and transaction costs. New technologies can offer more efficient solutions for equity issuance, corporate governance, asset management, investment services, product distribution and post-trade infrastructure. Regulation should facilitate this transformation, mindful of any risks to consumers and market integrity. Competition among diverse service providers should be promoted but also monitored to ensure that it is fair through a technology-neutral regulatory environment that provides a level playing field for all players.

Enforcement and integrity

- Investor protection and enforcement are key elements in the proper functioning of a truly single market. More supervisory convergence contributes to the reduction of compliance costs and adds legal certainty. A robust enforcement regime in case of non-compliance strengthens the confidence of investors and thus increases the supply of capital and liquidity. Peer reviews focusing on national enforcement functions and sanctions regimes could facilitate more efficient and coherent enforcement in the EU.
- A culture of integrity in the financial service sector is key to restoring public trust. It is necessary to pursue work by improving the tools and frameworks for fighting financial crime, money laundering and market

abuse. Investors should have access to fair and efficient complaint and mediation services across borders.

Best practices

- Legislation alone will not deliver the CMU. Member States, national authorities and the financial industry all play vital roles in building the CMU. Non-regulatory solutions, such as best practices, should be promoted and shared among Member States. For example, nationally implemented employee share-ownership schemes and investment savings accounts have shown promising results by providing an incentive for retail investors to participate in capital markets.

Issues for discussion

- How to improve EU citizens' access to cross-border savings and investment services?
- What are the main obstacles for SMEs to access cross-border non-bank finance?
- From the perspective of institutional investors, how to increase the attractiveness of EU capital markets and healthy long-term risk-taking?
- How to make the European capital markets more competitive, open and attractive internationally?