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The priority areas for the CMU

The imbalance that exists in the European Union between bank and capital markets funding makes the EU less competitive and less financially stable than it could be. Creating globally competitive markets takes time and we have yet to fully achieve that, but the UK's withdrawal from the EU reinforces the urgency of this goal: in the aftermath of Brexit, the EU will only be able to compete effectively with other major financial centres and reinforce its economic growth if its financial markets are sufficiently sizable – and further integrated. Moreover, in the context of the COVID-19 pandemic and its economic fall-out, stronger EU capital markets may play an important role in the recovery phase.

While the CMU is, in its current form, a relatively new project, achieving common capital markets is, more generally, a long-standing EU goal. Much progress has already been made, with successful market integration being observed in areas such as funds, trading venues, and clearing. Looking forward, efforts should be focused on three priority areas which are essential to achieve a successful CMU: (i) Develop retail investor participation in EU capital markets; (ii) Improve capital market access for EU SMEs; (iii) Ensure effective consistent supervision in EU financial markets.

Looking at successful capital markets across the globe, a high level of retail participation should be an essential characteristic of a CMU. Some of the key reasons for scarce retail investor participation is their lack of trust in capital markets as a result of mis-selling cases, as well as limited financial literacy. In addition, ESMA found in its 2019 and 2020 Reports on the performance and cost of retail investment products in the EU that costs associated with obtaining financial products are substantial and represent a significant reduction to long-term gains. Finally, due to a variety of disclosure rules applying, including on costs, it is not always clear to investors how different products compare with each other.

To address scarce retail participation in capital markets, several potential actions could be considered. Examples include: (a) further aligning disclosure requirements for investment products across different pieces of regulation and facilitating their cross-border distribution, (b) improving the distribution of financial products by looking into the incentives, like inducements, for advisors, and (c) reinforcing the role of pensions systems to stimulate retail participation in financial markets.

It is well known that EU SMEs tend to rely mainly on bank funding and that – when they access capital markets – they tend to privilege local markets due to easier access and lower information asymmetries for investors. For example, while venture capital funds can support the path towards IPOs, their presence is uneven across member states.

At the same time, it is fair to say that SMEs may pose increased risks for investors and it is challenging to develop rules that are appropriate for all types of SMEs at different stages of their development. The right balance should be found between making standardized information on SMEs available to investors across the EU, while the costs of such information to SMEs should be proportionate.

Other actions already taken in this area include the creation of SME Growth Markets under MiFID II. In this context, ESMA will soon launch a public consultation on an assessment of the functioning of the regime for SME Growth Markets. This consultation will include some suggestions to further promote the development of such markets in the EU.

Finally, regarding the role of supervision, it is well known that differences in supervisory practices increase the costs of doing business across the EU, and constitute a substantial barrier to cross-border investments. Over the past two years, the EU institutions have taken gradual steps towards expanding direct supervision at EU level. As a result, an increasing number of supervised entities will fall under ESMA's remit in the years to come. This concerns both EU and third-country market participants.

While the ESAs' review has introduced some useful changes to the supervisory convergence tools available to ESMA, these are less ambitious than those originally proposed. As such, there are further opportunities to enhance ESMA's supervisory convergence role further via a refined toolkit, especially regarding its ability to ensure the implementation of common supervisory practices. ■

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Rethinking CMU: the importance of local markets

Although many of the specific objectives initially envisaged in the context of the CMU project have been reached, we are still far from achieving a truly integrated an efficient capital market in Europe. Additionally, there is a need to rethink and relaunch the whole project considering challenges arising from Brexit.

Therefore, it is time to propose additional actions. From my point of view, the key priorities for the next phase of the CMU should be three: increase the equity market share in funding, tax harmonisation and supervisory convergence.

Firstly, the need to foster market-based finance for companies is especially acute on the equity side. Being listed broadens the possibilities of financing, boosts the level of professionalism and rigour in management, is an incentive to grow, gives prestige, strengthens the brand, helps to attract and retain talent, etc. and, since it is compatible with maintaining control, is a very natural solution for successful family businesses of a certain size. More listed companies also mean more transparent companies and even a somewhat more democratic society: it means that there are more companies within reach, either directly or through funds, for any investor. For these reasons, any restrictions on the capacity of firms to access capital markets should be removed and no extra restrictions or conditions should be imposed on companies associated with the fact of being listed.

Secondly, there is also a need to make progress on tax harmonisation. Current different tax regulations distort financial decisions, reduce efficiency in capital markets and influence too much cross-border capital flows. There is room to reduce the vast differences across Europe in the tax treatment of financial markets' transactions and SME investments. Heterogeneity in this area creates too diverging distribution models for financial instruments (insurance, banking and securities products).

Finally, the CMU project needs to emphasise the convergence of supervisory practices. In order to homogeneously apply the European rulebook it is of paramount importance that ESMA intensifies its efforts in supervisory convergence by using in all appropriate cases the tools and powers granted by law. Regarding the home/host supervisory model in the EU, it would be an improvement if the host NCAs were provided with the appropriate information on the activities carried out in their jurisdictions. The establishment of formulas for cooperation between home and host authorities is essential in order to avoid a "race to the bottom".

This is especially relevant in a context in which there is certainly a need to create an integrated, competitive, deep and liquid capital market, but this should not imply the creation of a single or dominant financial centre or the weakening of the main European local markets, i.e. any additional actions to relaunch CMU must coexist with strong local financial markets. They benefit medium-sized companies that are large enough to tap local capital markets, without preventing them from looking for capital across borders. Geographical proximity lowers transaction costs, helps to overcome cultural barriers of entrepreneurs and helps investors to understand the businesses that they are financially supporting. ■