EU CAPITAL MARKET COMPETITIVENESS AND INTEGRATION

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Competitiveness? We are doing quite well.

Facing the task to analyse the competitiveness of EU capital markets, I had to sort my thoughts and started by consulting the digital algorithm of my searching engine. The first result was the World Competitiveness Centers' ranking of the International Institute for Management Development (IMD). The IMD-competitiveness indicator combines 333 competitiveness criteria with statistical data (2/3) and survey data (1/3), the latter obtained through a business executives' survey.

Details indicate that IMDs assessment of the overall "competitiveness"-performance is determined by economic, political, social and cultural dimensions. In their view, governments need to provide an environment characterized by efficient infrastructures, institutions and policies that encourage sustainable value creation by enterprises. For them, the countries which are on top of the list, each have a unique approach of becoming competitive.

Among the 63 countries assessed in 2022, Denmark reached the first place in the overall assessment, Sweden is number 4, the Netherlands 6, Finland 8, Norway 9, Ireland 11, Luxembourg 13 (while in the economic assessment Luxembourg reached the first place). Germany is number 15 in this list, followed by many other EU member states.

The closer one looks into the results, the clearer the picture becomes. No real surprise for persons with an economic background and interest in economic questions like the participants of the EUROFI. In particular, CEE- and Baltic- member states as well as some of the bigger countries in the south had potential for improving. Why am I writing so detailed about this ranking?

In my view, the EU does quite well. Though the ongoing global turbulences the financial sector proves to be stable. Financial market participants are much better capitalized than ten years ago, the internal governance has improved considerably and the Single Supervisory Mechanism functions well. Micro- and macroprudential measures stabilize the whole system.

Capital market participation could undoubtedly contribute to the competitiveness of the EU.

Digitalization is prominently on the agenda, though we have to await the transposition of relevant legislative acts as well as the results of the discussions concerning the digital Euro.

Does the EU have a unique approach in becoming competitive? Of course, the diversity and broad range of competences is unique. We prove to have common understanding, are able to finding solid solutions and overcome differences, where necessary.

I also have the impression that especially capital market participants see the distinctive approach of the EU in climate-risk-related matters. The EU is committed to implement sustainable solutions which are also important in a long-term perspective thus enabling new investment opportunities by this approach.

Regarding the capital market related initiatives of the EU, I have the impression that we enabled relevant improvements. The legislative projects of the last legislative cycle are implemented. The EU was able to get quite well through the tense and regrettable process of the withdrawal of the UK-membership. The EU also responded swiftly when energy market disruptions occurred. The rise of the reference interest rate of the European Central Bank should bring down the high inflation, one of the economic effects of the Russian offense and the war in the Ukraine.

The Capital Markets Union-related initiatives of the on-going legislative cycle should make EU-companies more visible, improve the transparency of business behaviour, especially when it comes to sustainability criteria, enable more attractive products and liquid markets and further improve the EU-competitiveness.

However, more has to be done, sound and effective solutions have be implemented, especially when it comes to medium-sized or small Member States and companies. In my view, especially smaller and medium-sized companies also need local infrastructure to grow, adapt to evolving challenges and to receive investments by way of the capital market. I have the impression, we should start reconsidering how centralization of revenues while de-centralizing tasks can be prevented and implement suitable EU-solutions.

The upcoming retail strategy will furthermore have to prove to what extend it is able to make investments in capital markets more attractive and profitable for retail investors. While we have indications that customers become more attracted by investment products and financial education improves, progress in the capital market participation of customers could undoubtedly contribute to the competitiveness of the EU.

NATASHA CAZENAVE

Executive Director - European Securities and Markets Authority (ESMA)

Strong standards remain the foundation of vibrant & competitive capital markets

With the major geopolitical and market developments we have experienced since the Capital Markets Union plan was first launched in 2014, the arguments for competitive, vibrant, and integrated capital markets in the EU have only been strengthened over time.

There is a renewed urgency for building a resilient and diversified European financial system, capable of providing the capital our economies need to fund their growth and to withstand sudden economic shocks. Well-functioning capital markets are also critical to the success of the EU's green and digital transitions, as public funding will not be sufficient. Crucially, our capital markets must work for the direct benefit of EU citizens and ensure that retail investors can safely participate in these markets.

Regulatory changes to this aim have been incremental over recent years. Co-legislators are currently discussing the proposal to create a European single access point where investors can find financial and non-financial information, as well as discussing the more recent Listing Act proposal, which aims to simplify the listing and post-listing process to make public capital markets more attractive for EU companies. A new framework for European Long Term Investment Funds was also recently adopted, which aims to foster long-term investment in the real economy.

Moreover, the ongoing MiFIR review foresees the introduction of the long-awaited consolidated tape, which will centralise market data covering the price and volume of securities being traded across the EU. Importantly, the EU is committed to be at the forefront of both the green and digital transitions, making significant changes to foster an ambitious European wide approach from the outset.

However, while the EU has made inroads in bringing forth regulatory reforms in key areas of financial services, progress must equally be made in areas beyond for the CMU to be a success. In particular, there is a need for more efficient and harmonised insolvency laws (upon which the Commission has recently proposed a new Directive), addressing the debt-equity bias in terms of taxation, and finding a common approach for retrieving withholding taxes on investments.

When markets operate effectively, it makes them competitive and attractive for firms and investors.

From ESMA's perspective, we do not believe that there is a trade-off between regulation and growth. Well-designed regulatory frameworks bring about well-functioning, transparent and stable markets. When markets operate effectively, it makes them competitive and attractive for both firms and investors. We endeavour to achieve this by ensuring that rules are clear, consistent, and proportionate. In particular, we do our utmost to foster a convergent approach to supervision of those rules across all 27 Member States. ESMA uses a broad set of tools to achieve this, for example, by setting common EU supervisory priorities, conducting common supervisory actions or establishing voluntary supervisory colleges. Yet, there is scope to enhance ESMA's capabilities further in this regard.

Improving ESMA's ability to issue true no-action letters is one example of how better regulatory flexibility and EU-wide decisions can safeguard market efficiency.

At the same time, it's important to be clear that fostering competitive markets must not mean tearing up the rulebooks to do so. If the stress events we have experienced these past months has illustrated one thing, it is that turmoil in one country can rapidly affect another. In an interconnected global financial system, the chain is only as strong as its weakest link. It is therefore fundamental that we remain faithful to global regulatory cooperation and apply strong globally aligned standards.

Finally, we are conscious of the debate as to the direct role that regulators might play in promoting competitiveness in markets. At ESMA, while being mindful of the global nature of financial markets and the potential for regulatory decisions to impact market behaviours, we believe regulators should focus on our core duties of preserving financial stability, orderly market and investor protection. Therefore, our view is that any additional mandates to promote competitiveness are not warranted.

Capital markets play a key role in allocating capital and diversifying risk. Building deeper, more integrated, and stronger capital markets, with citizens and companies at the centre, is therefore in the broader public interest.

Pursuing a regulatory agenda to address these goals, while retaining a commitment to financial stability, investor protection and adherence to international standards, will ultimately build more stable, efficient and competitive capital markets in the EU.

FRANCESCO CECCATO

Chief Executive Officer - Barclays Europe

Moving beyond incremental reform to a true CMU

It was a positive development that the Commission's last Capital Markets Union action plan, published in 2020, proposed a relaunched CMU that has a stronger focus on EU market integration, SME financing and retail investment. Legislative proposals have followed, including the establishment of a single access point to company information and a review of three key capital market legislations: AIFMD, ELTIF and MiFIR. Further actions proposed or planned include a proposal for an EU Listing Act, targeted harmonisations of the corporate insolvency framework, an open finance framework and initiatives to develop financial literacy.

However, now reduced to a trickle of incremental reform, the CMU risks becoming a missed opportunity that avoids the difficult questions and does little more than tinker at the edges of the problem. Regulatory proposals have had little success so far in helping advance the creation of a unified capital market in the EU, and despite the incremental reform, EU equity markets are making slow progress overall, with the EU's equity finance gap continuing to widen compared to global peers.

The EU is performing far below its potential, reflected in the declining proportion of global equity market capitalisation of listed shares. This fall is a result of a combination of factors – an ongoing trend of company delistings, fewer IPOs and most recently, lower company valuations linked to the uncertain economic outlook. As a result, the EU as a whole is becoming less and less attractive as a place for businesses to access deep pools of capital and go public.

Comparing the EU with the US, from the investor side the picture is mixed, but overall investment in domestic equities in Europe is far less substantial than in the US. EU pension funds lag behind the US as a source of domestic equity investment. The picture is comparatively more encouraging for insurance companies and investment funds, but a limited focus on EU equities is evident across the board. Education to build confidence and trust in equity markets is critical to developing an investor culture entailing significant investment from individual EU consumers. Without this, EU capital market growth will remain dependent on non-EU stakeholders and will be impeded. The CMU's ambition in its last action plan to develop financial literacy should be broadened and furthered with this in mind. On the legal and regulatory side, the impediment lies in the continued struggle of the CMU to achieve its "single market" ambitions. This needs to be fulfilled in the following ways:

- Harmonisation of the corporate insolvency framework was a hoped-for ambition of the last action plan but has not been delivered as yet. This is particularly important in addressing the challenges of fragmented legal regimes that hinder the debt market and should be a priority for CMU.

The CMU risks becoming a missed opportunity that avoids the difficult questions.

- Building on company law frameworks such as the "societas europaea" and the takeover bids regime, the development of a system of pan-EU company law.
- Development of measures to increase capital markets financing and move away from reliance on bank financing, to improve competition and dynamism within the markets, and increase financial stability. A move away from reliance on bank loans is likely only to be fully successful if there is a harmonisation of insolvency and property laws across the EU to give clarity to investors.
- Reform of the European Securities and Markets Authority into a single, strong centralised securities regulator, similar to the Securities and Exchange Commission in the US, and removal of decentralised regulatory control from member state regulators.
- Reform of foreign and direct investment regulation to address barriers which disproportionately inhibit investment in the EU from outside, and indeed even as between EU countries.
- Finally, there is work the banking industry can do to support all of this. There is an extent to which a true banking union is a pre-requisite for a true Capital Markets Union. In other words, the market needs to see the development of banks that are truly integrated pan-EU firms which can act as the facilitators of capital flows between savers and the real economy. In possession of the correct regulatory licenses, EU banks can already facilitate this by providing a marketplace for corporates and investors.

Capital Markets Union is a critical initiative for the European Union and given a sufficient level of political priority can deliver substantial economic benefits for European citizens.

STÉPHANE BOUJNAH
Chief Executive Officer and Chairman of the Managing Board - Euronext

The EU must end the era of unilateral disarmament

The strategic autonomy of Europe requires competitive capital markets to transform EU savings into investments and to attract foreign capital. But the EU cannot depend on foreign third parties to power European markets and ensure the financing of the European economy. Improving the competitiveness of capital markets in the EU cannot rely on a single financial centre, but depends on interconnected and integrated markets. The financing of the EU economy must be supported by an ecosystem of strong EU-based players who are not sub-groups of the "EMEA – Europe, Middle-East and Africa" division of global companies.

Progress is needed to increase equitization of the European economy. Since 2016, the cumulated market capitalization on EU markets has represented on average 80% of GDP compared to 160% in the US, and 130% in the UK.

Competitiveness must be a central part of the CMU objectives. But regulation must not translate in a 'race to the bottom' with other jurisdictions. It should rather be part of an effort to develop EU markets and empower EU-based participants. That is why Euronext has championed a competitiveness test to assess unwanted consequences of new EU regulations.

Much of the current EU legislative agenda encompasses these objectives. The clearing reform proposals under EMIR 3.0 can improve the competitiveness of European CCPs, with a prioritisation of the measures required to enhance the attractiveness of clearing in the EU. On the primary markets side, the Listings Act proposals focus on simplification and harmonization within the Prospectus and Market Abuse Regulations.

However, some proposals are detrimental to the long-term competitiveness and strategic autonomy of EU markets. A consolidated tape (CT) can help market participants and investors better navigate the EU trading landscape. Euronext is establishing a Joint Venture with 13 other European exchanges to prepare a tender application as a CT provider. However, policymakers must avoid imposing superficially attractive, yet ultimately damaging, solutions such as the introduction of a real-time pre-trade data tape, which would only increase the opportunities for latency arbitrage and lead to value destruction in local markets.

Strong EU finance-makers are the key to the competitiveness and strategic autonomy of Europe.

A CT is not a silver bullet to resolving issues of trading fragmentation and declining transparency. These challenges require significant intervention on market structure. We have not seen such an ambition. On the contrary, some current proposals would increase dark and discretionary trading, notably by allowing systematic internalisers to trade further away from market prices. This would move trading away from the lit orderbook, hamper price discovery and hurt investors. It will mostly benefit non-EU participants and increase the dependency on foreign third-parties.

It is up to EU companies to offer the right set of services to attract issuers and capital. This is what Euronext has been trying to achieve since the IPO in 2014. The Group has expanded significantly and operates regulated markets across 7 European countries. On 27 March, Euronext migrated the trading of equities listed on the Italian exchange on its single European liquidity pool, enabled by a single order book, empowered by the Euronext proprietary technology platform, Optiq®. Issuers and investors can now access a single liquidity pool with an aggregated market capitalization close to € 7 trillion, which is twice the size of the London Stock Exchange one. In 2022, more than 25% of European equity flows have been traded on Euronext platform, and average daily value of traded equity have been close to € 11 billion.

Euronext does facilitate access to public capital, in particular SMEs, by nurturing local ecosystems, through its pre-IPO programme TechShare launched in 2016, and through the Euronext Tech Leader index created in 2022. This is a stark difference with many non-EU actors, which cherry pick the most profitable businesses with large blue chip companies and do not bother with SMEs, technology companies and local ecosystems.

Euronext is also expanding the capabilities of EU-based finance-makers by internalizing the clearing of transactions, within Euronext Clearing, a EU-controlled CCP. This strategic move will reduce dependency on non-EU third parties and increase the strategic autonomy of EU markets.

Competitive, strong EU-based finance-makers are the key to the competitiveness and strategic autonomy of Europe. The EU must be more ambitious and promote the building of a continent of finance-makers, not just a territory of finance-takers. The world around Europe is changing, and the EU must end the era of unilateral disarmament, in particular when it comes to financial regulations. Policymakers need to carefully consider the unwanted consequences of any regulatory changes, whose effect would be to destroy EU financial markets as we know them. Any damage to the EU finance industry capabilities will be lasting, hard to reverse and detrimental to the financing of the European economy.

JAN BOOMAARS

Chief Executive Officer - Optiver

A new playbook for Europe's capital markets

Next year, EU citizens will elect the next Members of the European Parliament (MEPs). With these elections, the European Commission also gets new political leadership.

Rather than following the same playbook for capital markets, the focus should be on creating a true single market for financial services, finding innovative ways to bring more retail investors into the market and taking an evidence-based and proportionate approach to rulemaking that champions a diversity of market participation.

Much has been achieved for financial markets in the EU – increased transparency from MiFID II, important investment product regulations, simplified listing rules, a harmonised anti-money laundering rulebook and progress toward banking union. But too often competing objectives have stifled progress, especially on CMU. For instance, in crafting prudential rules for investment firms, policymakers set out to create a bespoke regime for a diversity of market participants. Instead what we got is a one-size-fits-all application of banking rules to firms with no banking activities. This contradicts the notion of a CMU with diverse market participants and should be addressed in the next mandate.

Beyond that, next year's leadership should focus on a small number of goals with the greatest potential to transform capital markets. In that spirit, I offer three recommendations.

Create a truly single market

On paper, the EU boasts a single rulebook for financial services. But in practice, each member state implements EU rules in its own way; applies varying levels of supervision; imposes different compliance obligations; or sets different standards for market access. So in reality we have a landscape fragmented into 27 different parts. Investors face difficulties when they confront diverging tax regimes, insolvency laws and post-trade practices. For example market making activities face different regulatory treatment across member states. In effect, we have a single rulebook but no harmonised supervision or enforcement of that rulebook.

Giving ESMA more teeth is one way to improve this. ESMA's decisions rely largely on member state supervisors, making it difficult for it to enforce the single rulebook and ensure supervisory convergence. Ultimately, ESMA needs broad powers to police, enforce and make technical rule changes when needed. We could start by giving ESMA direct oversight over EU trading venues and exclusive product intervention powers.

Encourage Europe's retail investors

Increasing retail participation is a win for EU citizens, markets and the economy. It gives individuals access to broader, more competitive investment choices, contributing to their retirement savings. Markets grow more efficient, stable and robust with a greater diversity of market participants.

> **We have a single rulebook for financial services, but in practice we still have 27 markets.**

The world often looks to the US for lessons on how to stimulate smaller investors. That's a mistake. Retail investors in the EU are different, so why treat them like they're the same? An area where this could be particularly relevant is in improving investor education. Armed with data on retail trading trends, regulators could pursue evidence-based initiatives, like adding basic financial knowledge to school curriculums or encouraging institutions to use social media to promote financial literacy.

Products and practices that lead to poor outcomes should be eliminated. Germany's single market-maker venues, for example, which studies show lead to worse prices for retail investors, should be required to operate on level footing with other EU venues.

Finally, structured products, which are more costly, less liquid and transparent, and expose investors to greater counterparty risk than comparable exchange-traded products, should be restricted for retail. Spain is contemplating banning CFDs for retail. That's the right response in spirit, but EU-wide restrictions would accomplish the same, while contributing to a harmonised EU rulebook that's easier for retail investors to navigate.

Pursue evidence-based rule-making

EU rules often end up being more complicated than is necessary and too frequently apply a one-size-fits-all approach that is not appropriate for the diversity of market participants. Of course this is a function of competing political interests, but the results do little to improve capital markets or encourage trading and investment in the EU.

The objectives behind EU rules are usually sound, but they get distorted by politics. A more proportionate, evidence-based approach would help grow capital markets with a diversity of market participants. Rulemaking based on empirical data and research means informed decision-making, bespoke rather than prescriptive rules, and transparency to boost trust and confidence in the financial sector.

All of these objectives together would create a virtuous cycle between regulator and regulated. Focus on these and Europe's capital markets will be in a healthier place when the next class of MEPs wraps up their terms six years from now.