Deep and integrated capital markets for a resilient and competitive EU

Dutch vision and priorities for the next steps in strengthening the Capital Markets Union

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The importance of capital markets

A strong Capital Markets Union (CMU) is a key pillar of the EU's internal market. The benefits are numerous, but its core lies in supporting our sustainable economic growth and strengthen the Union's macro-economic and financial stability. Deep capital markets provide companies with a more diverse, flexible, and resilient source of funding at every stage of a company's life. More risk-bearing private finance provided by various capital market participants is urgently needed to finance (scientific) innovation and the transition to net zero.

Capital markets complement the dominant bank credit financing in the EU. A more diverse funding landscape can free-up bank balance sheets to support SME financing. Returns from these investments can accumulate wealth of EU households, indirectly via pension funds and asset managers or through direct investments in public and private markets. A better functioning and deeper capital market will contribute to the financial and economic stability in the EU, as well as its competitiveness globally. More developed, efficient, and open capital markets therefore increase the financial wellbeing and security of EU citizens now and in the future.

Deeper and more integrated capital markets in the EU are more urgent than ever.[1] Recent geopolitical developments and crises have created renewed urgency for deepening and strengthening the CMU. Companies and industries still depend heavily on banks for their financing needs, whereas investments in the twin transitions and (economic) security and defence of Europe call for more market-based and risk-bearing financial instruments. There is a need for improved financial literacy of EU citizens in an ageing population, being able to make healthy choices to improve their prosperity. This requires markets to be further developed and become less fragmented to be more attractive for all participants.

Our view on the CMU objectives

To address the aforementioned challenges we call for deep, integrated and resilient EU capital markets.

- **Deep capital markets** to provide sufficient available diverse, flexible, risk-bearing financing options for European companies and industries and the transition to a sustainable and digital economy.

- **Integrated capital markets** that provide citizens and investors with good savings and investment options for wealth building, and companies at every stage of growth with financing possibilities.

- **Resilient capital markets** with cross-border capital ownership for a stable, competitive, and strategically autonomous open European economy.

[1] See e.g., New Financial (2023), EU Capital Markets: A New Call to Action; ECB (2023), A Kantian shift for the capital markets union; IMF (2019), A Capital Market Union for Europe; IMF (2023) Background Note on CMU for Eurogroup.

Strategy – how to achieve our objectives

Focus objectives to increase **urgency**

There is no silver bullet to the CMU. The CMU-project consists of many individual building blocks. Among them are improved or relaxed regulation for certain financial market activities, increased transparency on markets and better adapted related legal frameworks. Focussing all attention on a single of few actions will not bring closer the objective of the CMU.

Instead, the EU should improve the 'C', 'M', and 'U': mobilize the available *capital*, allow it to be allocated efficiently through open, integrated *markets* with sufficient, competitive market participants within a resilient *union* with a robust regulatory framework. This narrative shows the interconnectedness of the need for deep markets, diverse funding channels and good market access. It allows us to focus on the challenges in each category, while pointing at the consequences of not addressing one of these pillars – the efforts in another will not bring the expected results.

Continuing the CMU project requires increased urgency and political commitment. While there is broad support for the objectives of the CMU, achieving them in practice has shown to be more challenging. It requires politicians to make long-term decisions, nationally and at EU-level. Decisions that impact citizens, (small) companies and the financial sector. For the CMU to succeed, we need political commitment and willingness to look beyond previous obstacles from all Member States to make these decisions and achieve our common goals.

- The CMU is a long-term project and a must have. Progress will be achieved incrementally, but we should start today to lay the foundations for tomorrow. This requires a **better explanation of the consequences of underdeveloped capital markets** for employment and retirement income. The added value of deep and integrated markets for households and businesses should be better explained for more dedicated commitment.

- In the past decade important steps have been taken with two consecutive CMU action plans to develop and integrate the EU's capital markets. However, **while some building blocks are in place, the framework still has gaps**. More work is needed to fill these gaps and connect the dots. Now that the low hanging fruit has been picked, we need a good assessment on how to address the remaining structural barriers and how to develop, deepen and integrate our local capital markets to bring a full-fledged CMU closer.

Deploy a wide range of **measures**

We need a combination of EU-wide and national initiatives. Further developing capital markets in the EU requires further EU-wide 'top-down' initiatives to improve integration of local markets and reduce fragmentation. Simultaneously, we see the need for parallel action by individual Member States as well as by market participants to deepen and develop local or regional capital markets 'bottom-up'. This combination will allow for the build-up of deep and integrated capital markets in the EU.

- National initiatives and action plans should be based upon needs assessments and evaluations of the current state of capital market development. **Commonly identified building blocks** could be deployed to make swift progress and make use of proven concepts in other countries. However, entire blueprints may not be easily copied and pasted. Therefore, national actions could be targeted to local demands and practices, insofar as they align with EU-wide objectives and standards in order to advance convergence.

- To achieve objectives related to reducing fragmentation and making the EU's capital markets as a whole more attractive, differences in the level of development of capital markets and contribution of capital market activities to the economy between Member States should converge. **Member State-specific recommendations** are an effective tool to prioritize bottom-up actions and allow for convergence within the EU while contributing to the overall CMU-goals.

Actively involve **stakeholders**

- Capital markets consist of capital and participants. In the end, **policy makers in Brussels and national capitals do not build the CMU**. It requires active participation, collaboration and initiatives from all stakeholders: consumers and investors providing capital, companies seeking finance and the financial sector connecting both sides with infrastructure, products and services. Their support of the goals and individual measures, as well as the usage of newly created possibilities is essential for the success.

Priorities – which measures to take

Deep pools of **Capital**

Build pools of long-term capital. We should shift part of households' savings from bank deposits to investments. These complementary capital income streams for citizens can address challenges of the ageing population. Diversification of wealth portfolios and cross-border investments improve financial stability and the resilience of the Economic and Monetary Union (EMU).

- **Increase the volume of pension assets by developing national pension systems**, aided by the exchange of best practices such as auto-enrolment, tracking systems and pension dashboards to assess pension adequacy. (*Member States)*

  Pension funds provide deep pools of capital that allow for scale and diversification in their investments. They can stimulate companies' investments research, development and growth through allocation of capital. For example, to venture capital funds which can provide funding for bigger tickets and companies and projects with higher risks profiles, allowing financing in various key stages of scaling up.

  We encourage Member States, employers, leaders of industry and social partners to create pension schemes as part of their remuneration packages by providing (tax) incentives on a national level. These initiatives can be supported by employers and social partners through establishing their pension schemes through regulation, providing a level playing field for (auto) enrolment. This can be further aided by standardization for pension tracking systems and pension dashboards to assess pension adequacy at national level.

- **Develop a simple EU retirement savings account** as a third pillar complementary pension product for underdeveloped national pension systems and workers without access to occupational pension schemes. *(European Commission)*

  The account should be a simple low-cost product that allows easy investing in best-of-class, value-for-money, inducement-free (exchange-traded) financial instruments including shares, bonds, ELTIFs and UCITs. Member States are encouraged to provide tax incentives nationally. To support EU sustainable economic growth and competitiveness, it could be assessed whether a certain percentage of the account is encouraged to be invested in EU instruments without compromising the desired level of portfolio diversification.

- **Improve financial literacy of citizens to better empower them to make healthy financial choices** through national actions making use of the OECD/EU financial competence frameworks. (*Member States)*

  Financial education will better prepare consumers for financial decisions during different stages of life, and at life events that impact their financial situation. Higher financial literacy levels will also enable more households to plan their financial future and protect them from using financial services that do not contribute to their financial health. For example, Member States can share best practices and explore the potential benefits of (facilitating) financial health checks.

- **Encourage private investments in scale-ups** by an assessment of among others, the fiscal framework, increasing the availability of large investment funds for late-stage/cross-over financing and better available and comparable company data. *(European Commission and Member States)*

  To support the twin transitions, European competitiveness, security, defence and economic resilience, innovative public listed companies are important. In the business life cycle from start-up, scale-up, grown-up to public listed company, every stage needs investments. Public investments are needed in some phases, but private investments are essential in every phase.

  Therefore, we need to boost private investments by standardising fiscal and corporate law, for example by facilitating digital means of meeting to encourage international shareholding and improve the ability to exercise shareholder rights across borders. We should also assess how we can facilitate the creation of large, EU-wide later-stage (venture capital) funds that could participate in larger financing rounds and offer an investment opportunity for other (smaller) asset managers and investors.

Integrated **Markets**

Integrate the EU's capital markets. Capital markets' infrastructure and supervision are fragmented. Through further standardization and harmonization of rules, data, and supervision, we can improve the attractiveness of EU capital markets to increase its competitiveness.

- **Improve comparability and usage of sustainability information** for investments in transition and sustainable activities, through further alignment of the sustainable finance framework. *(European Commission)*

  Significant steps have been made towards enhancing sustainability information, as evidenced by the implementation of key measures like the SFDR, Taxonomy, CSRD and CSDDD. These initiatives form the foundational building blocks of the sustainable finance framework. However, there is now a pressing need to refine and better harmonize these components and better align disclosure requirements. This will not only make them more comprehensible to stakeholders but also ensure that companies can comply without facing excessive administrative burdens. Such improvements are crucial for securing widespread support and furthering the policy objectives of the Sustainable Finance Action Plan.

  The EU sustainable finance framework lays the foundation for investment in both green and transition activities. However, its perceived focus on green activities alone calls for clarifications and targeted amendments. It should therefore include 'transition' finance.

- **Standardize reporting to (national) regulators and develop centralized data collection** by building IT-systems and data storage at ESMA. *(European Commission)*

  A first step towards a strengthened common rulebook and centralized financial supervision is to standardize reporting and establish central data collection and data storage at EU level. In our view, the supervisory objectives can be better achieved if there is an integral data set. A more comprehensive overview would benefit supervision, in particular regarding cross-border market activities. Moreover, it reduces IT and compliance costs for both financial companies and national supervisory authorities, as the latter do not have to build data infrastructures nationally and supervised entities can submit via one central hub.

- **Continue working towards improved single EU supervision** in a sequenced and targeted approach. *(European Commission)*

  This approach should include the development of an assessment framework at which level supervision is best placed, more supervisory convergence in EU-legislation, and an assessment of required improvements of the organisation and governance of ESMA. A step-by-step approach towards further harmonisation of supervisory practices is essential to ensure a smooth transition and to maintain a high standard of supervision and trust in the financial markets.

  The assessment framework should be applied to identify eligible activities and sectors, such as wholesale markets and activities that are highly cross-border, to be supervised directly by ESMA. On the contrary, (smaller) national and retail-focused activities benefit from local supervision as long as the common rulebook is implemented and enforced equally to prevent regulatory arbitrage. To grow towards improved single supervision, best practices and inspiration drawn from the prudential banking supervision under the Single Supervisory Mechanism (SSM) should be carefully taken into account. An approach whereby ESMA first coordinates and then centrally manages supervision in close cooperation with national supervisors – in supervisory colleges – benefits from clustering and leveraging (national) supervisory expertise and knowledge.

  Further supervisory convergence can be achieved by making more use of regulations instead of directives and by providing less national options or exemptions. Finally, the governance of ESMA should be assessed on its ability to be better equipped in its role to enforce supervisory convergence. Adequate additional resources for ESMA should be provided accordingly to perform its enhanced supervision tasks.

- **Reduce fragmentation in capital market infrastructure** through further standardisation to facilitate better cross-border investments. *(European Commission)*

  Currently, many European companies are going public in the United States because the EU lacks stock markets with sufficient deepness, liquidity and scale. To make listings and investments in companies in the EU more attractive, we should reduce market fragmentation by further standardising listing criteria. We should also analyse the securities law of Member States to identify aspects which could be streamlined in order to foster cross-border investments and reduce fragmentation of EU market infrastructure to allow for more competitive markets.

- **Assess and improve, if appropriate via harmonisation, the key elements of insolvency law** that hamper cross-border investments and the free movement of capital. *(European Commission and Member States)*

  The work on improving the functioning of the insolvency frameworks should continue to foster cross-border equity investments. Taking into account all interests, the options to improve – and if appropriate harmonise – the applicable rules and procedures in a targeted and proportionate manner should be examined with a view to further improve the functioning of the insolvency frameworks for companies and investors.

A resilient **Union**

Facilitate a broad range of market-based financing options. A more diverse funding landscape will reduce companies' reliance on bank lending, allowing banks to free up their balance sheets and focus more on lending to smaller companies. Therefore, we should make the regulatory framework more fit for purpose without jeopardising market integrity and stability.

- **Improve the effectiveness and proportionality of the prudential framework for investment firms** to ensure it remains prudentially sound and capital markets are liquid and attractive for investors. *(European Commission)*

The investment firm regulation and directive provide a good framework to address prudential risks stemming from the activities of investment firms. Nevertheless, experience over the past few years has shown that some of the provisions hinder capital market development and create an unlevel playing field due to adverse effects on market makers, while this is not necessary from a risk perspective. For a globally competitive, liquid and prudentially sound capital market, targeted amendments should be considered for the upcoming IFR/IFD review. In particular, the classification criteria, capital requirements and governance requirements should be assessed to ensure proportionality and better fulfilment of a risk-based regulatory approach.

- **Take taxation out of the equation** to encourage market financing in European companies. *(Member States)*

  Currently, corporate debt is more attractive than equity for tax reasons. By minimizing the impact of taxation in the consideration of companies in the manner of funding and creating a more equal level playing field, we can enhance equity investments and contribute to a more diverse and flexible financing landscape for companies. These investments can foster innovation and economic growth. Member States are encouraged to reduce the debt-equity bias in their national tax systems and share best practices among each other.

- **Improve the prudential framework for non-bank financial intermediates** by further developing the framework for macroprudential policy and reviewing the money market funds regulation. *(European Commission)*

  Non-bank financial intermediates can facilitate more diverse, market-based funding for EU businesses. We need efficient and stable financial markets to support our economy. However, experience has shown that some of these intermediates, particularly money market funds, could react procyclical to economic shocks, exacerbating a potential crisis. These risks require a solid prudential regulatory framework with effective microprudential and macroprudential tools to deal with liquidity stress, taking into account international developments, for example frameworks and assessments in other relevant jurisdictions.

- **Assess the possibilities of improving visibility of SMEs to investors** by examining whether finance seeking EU companies and investors favour development of a voluntary IFRS-light regime for EU SMEs. *(European Commission)*

  SMEs are less visible for investors than large (listed) companies, because of less accessible and comparable financial information. This hampers their access to (equity) financing and capital to innovate and grow. We therefore see the need for an assessment of the demand of (finance-seeking) companies and of investors for the development of a voluntary simplified IFRS-regime for SMEs. This assessment should regard the endorsement of the IASB IFRS for SMEs and the creation of an optional 28th (EU) IFRS-light regime for SMEs seeking financing. It should also assess how this could alleviate the administrative burden for those SMEs.

- **Identify barriers in the securitization framework** in order to unlock institutional investors' capital for SME lending. *(European Commission)*

  To improve the functioning the securitization market, we see the need for a review of the current barriers and possibilities to foster safe and transparent securitizations. At the same time, for resilient capital markets safeguarding financial stability remains a priority. We should therefore be wary to make far-reaching changes in the prudential framework, especially when they lead to a deviation from Basel.

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