Summary: BUILDING MORE EFFECTIVE AND ATTRACTIVE CAPITAL MARKETS IN THE EU

Overview

This summary provides an overview of the position paper titled 'BUILDING MORE EFFECTIVE AND ATTRACTIVE CAPITAL MARKETS IN THE EU' published by the European Securities and Markets Authority (ESMA) in May 2024. The paper evaluates the current state of EU capital markets and outlines a series of recommendations aimed at improving their efficiency, scale, and appeal to investors and companies. It addresses the necessity for broader investment opportunities for EU citizens, enhanced financing options for European businesses, and the advancement of regulatory frameworks to ensure agility, consistency, and competitiveness in the global market.

Section 1: The State of EU Capital Markets

EU capital markets are essential for financing economic activities, innovation, and fostering prosperity, offering businesses a means to raise funds and citizens opportunities to invest. Despite a strong history, these markets are fragmented and overly reliant on the banking system. The Capital Markets Union (CMU) plan, introduced in 2015, aimed to address these issues by diversifying financing sources and enhancing financial integration, but progress has been slow.

As of the end of 2023, the EU's share of global equity market capitalization was only 11%, a decline from 16% in 2009, and its share of global IPOs was 15%, less than half of the US's share. The EU's market infrastructure is also fragmented, with 27 Central Securities Depositories and 14 Central Counterparties, compared to just one of each in the US. The asset management sector is similarly divided, with a large number of UCITS funds in the EU, which affects fund scalability.

Looking forward, capital markets must support growth, innovation, and competitiveness, especially in light of the green and digital transitions. Attracting EU and international investment is crucial for strengthening industries and job creation. A more balanced approach to financing the economy is needed, emphasizing the development of effective and attractive capital markets in the EU.

Section 2: Broadening Investment Opportunities for EU Citizens

Strengthening EU capital markets involves mobilizing long-term capital and diversifying the investor base, which can enhance market efficiency and resilience. EU citizens, traditionally reliant on bank deposits, face different risk profiles when investing in capital markets but also have opportunities for savings growth and supporting the European economy. A shift in household savings from deposits to capital market investments could significantly impact funding choices for companies and unlock substantial economic growth. To foster a retail investment culture, straightforward, accessible, and cost-effective investment products are needed, along with independent advice and investor protection. Tax incentives could further stimulate retail investment. Institutional investors, including investment funds, pension funds, and insurance companies, are crucial in channeling retail investments into capital markets. There is potential to expand pension fund schemes across the EU to meet long-term financial security and retirement needs.

Section 3: Boosting the Financing of European Companies

The Capital Markets Union (CMU) project aimed to diversify financing sources for SMEs and startups, reducing reliance on bank financing. Despite progress, European businesses still predominantly use bank loans, with market finance accounting for only 30% of Euro area non-financial firms' funding in 2017, compared to 70% for US firms. IPO volumes in the EU have been flat over the past fifteen years, hitting a low in 2023, and more companies are de-listing from EU markets. Factors influencing public listing decisions include market integration, valuations, research coverage, and regulatory requirements. EU public equity markets have become less attractive for raising capital, leading to European savings being invested elsewhere, with the share of European stocks in UCITS equity funds dropping from 51% to 35% between 2015 and 2022, while US stocks increased from 27% to 42%.

To address these challenges, it is suggested that a range of financing options, including corporate debt and private financing like private equity or venture capital, should complement bank financing. The securitisation market's enhancement could improve the relationship between bank and market financing. The EU's market structure is complex and fragmented, especially in trading and post-trading infrastructures. Market entities should integrate activities and leverage technology, while policymakers should work towards a harmonised legal and regulatory environment to address fragmentation and promote market integration, which could bring economies of scale and facilitate cross-border capital flows. To make EU markets more appealing to investors and attract funding for European companies, measures such as tax incentives could be considered.

Section 4: Improving Regulatory Agility, Supervisory Consistency and Global Competitiveness

The European Union must improve regulatory agility and supervisory consistency to adapt to the rapidly changing financial landscape and maintain global competitiveness. The current regulatory framework is often rigid, necessitating a more dynamic and harmonized approach that allows for adaptability to market changes without the need for constant legislative overhaul. Supervisory practices vary across member states, leading to regulatory arbitrage and inefficiencies in cross-border operations, which undermines the single market's effectiveness. Enhancing supervisory convergence and collaboration among national authorities is crucial, as is considering the benefits of EU-level supervision where it adds value.

To modernize the regulatory framework, it is essential to adopt a forward-looking perspective that enables timely adjustments to emerging risks. This includes reevaluating the 'Meroni doctrine' to allow for a more flexible delegation of powers to EU agencies, which is necessary for maintaining efficient and effective capital markets. Without such reforms, EU capital markets risk falling behind globally, as other jurisdictions may act more swiftly. Recommendations include streamlining regulations, reducing red tape, and ensuring a level playing field to bolster the EU's position in the global financial market.