

Capital Markets Union: A Vision for the Long Term

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ABSTRACT

Capital Markets Union (CMU) is a welcome economic policy initiative. If well designed and implemented, it can improve access to funding, the allocation of capital, prospects for savers, and financial stability in the European Union. But since financial ecosystems only change slowly, CMU cannot be a short-term cyclical instrument to substitute for subdued bank lending. Shifting financial intermediation towards capital markets will require persistent action on multiple fronts. The policy agenda should aim to enhance both capital markets development and cross-border financial integration, two distinct but mutually reinforcing aims; to increase the transparency, reliability, and comparability of information, a key enabler of trust in financial markets which always involve information asymmetries; and to adequately address financial stability concerns. We propose a staged process to sustain the momentum and make Europe's CMU fully worthy of its 'union' label.

INTRODUCTION

The European Commission has created momentum around the idea of a European Capital Markets Union (CMU). The expression was first used by the then-Commission president-elect Jean-Claude Juncker in the initial exposition of his policy agenda in mid-2014.¹ It has since been described by Mr Juncker as one of three 'unions' the European Union (EU) is currently pursuing.² CMU has been prominently included in the title and job description of the Commissioner for financial services—or to give him his full title, the Commissioner for Financial Stability, Financial Services, and CMU.³ The Commission published a green paper on CMU in February 2015,⁴ and a more specific action plan in late September 2015.⁵ The

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¹ Jean-Claude Juncker, *A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change*, opening statement in the European Parliament session (European Commission, Strasbourg, 15 July 2014).

² The other two being the Energy Union and the Digital Single Market.

³ Jean-Claude Juncker, *Mission Letter to Jonathan Hill, Commissioner for Financial Stability, Financial Services and Capital Markets Union* (European Commission, 1 November 2014).

⁴ Commission, 'Green Paper: Building a Capital Markets Union' (Communication) COM (2015) 63.

⁵ Commission, 'Action Plan on Building a Capital Markets Union' COM (2015) 468 final.

announcement of CMU as a policy priority has elicited a number of substantial contributions from a variety of stakeholders.⁶

The creation of the CMU mirrors a broader shift in the European policy consensus. At the outset of the financial crisis in 2007–08, European policymakers often described the bank-based nature of Europe's financial system as a factor of stability, in contrast with the more exotic features of finance in the USA such as securitization conduits and other forms of 'shadow banking'. However, Europe's dependence on banks and the scarcity of alternative financing channels have since been identified as significant features of the European crisis and obstacles to its resolution.⁷ The president of the European Central Bank (ECB) illustrated the new consensus by observing that 'the crisis has shown the drawbacks of over-reliance on a bank-centred lending model. So we also need to develop reliable sources of non-bank lending, such as equity and bond markets, securitization, lending from insurance companies and asset managers, venture capital and crowdfunding'.⁸ In the debate on CMU, the reference to 'capital markets' is most often used as shorthand for such sources of non-bank lending, and is preferred to the expression 'shadow banking', which has more negative undertones.

This shift is welcome from an economic policy standpoint. Capital markets play an important role in sharing economic risks and smoothing consumption and investment. They can provide better access to funding. A well-designed CMU agenda should also make a substantial contribution to financial stability. The prior preference for bank-based finance ignored the advantages of a diverse financial system and the risks associated with the near-absence of alternative financing channels. It also led to insufficient development of forms of financing that are specifically suited for high-growth firms that are major potential creators of European jobs.⁹ During the crisis, over-reliance on banks was an obstacle to swift repair of the European banking

6 See in particular AFME, *Bridging the Growth Gap: Investor Views on European and US Capital Markets and How They Drive Investment and Economic Growth* (AFME/Boston Consulting Group, February 2015); Niki Anderson and others, 'A European Capital Markets Union: Implications for Growth and Stability' (Bank of England Financial Stability Paper No 33, February 2015); Blackrock, *The European Capital Markets Union: An Investor Perspective* (February 2015); Hugo Dixon, *Unlocking Europe's Capital Markets Union* (Centre for European Reform, London, October 2014); European Issuers, EVCA (European Private Equity and Venture Capital Association) and FESE (Federation of European Securities Exchanges), *EU IPO Report: Creating Jobs and Growth in European Capital Markets* (23 March 2015); Goldman Sachs, *Unlocking Europe's Economic Potential through Financial Markets* (Goldman Sachs European Economics Analyst 15/07, 21 February 2015); House of Lords, *Capital Markets Union: a Welcome Start* (European Union Committee/11th Report of Session 2014–15, London, 20 March 2015); Joseba Martinez and Thomas Philippon, 'Does a Currency Union Need a Capital Market Union?' (15th Jacques Polak Annual Research Conference, International Monetary Fund, 13–14 November 2014); Christian Odendahl, *The Low-Hanging Fruit of European Capital Markets* (Centre for European Reform Bulletin 101, London, 8 April 2015); Nicolas Véron, *Defining Europe's Capital Markets Union* (Bruegel Policy Contribution 2014/12, November 2014); William Wright, *Driving Growth: Making the Case for Bigger and Better Capital Markets in Europe* (New Financial October 2014).

7 See eg Nicolas Véron, *Europe Needs to Drop its Resistance to Non-Bank Credit* (Bruegel 16 April 2012); André Sapir and Guntram B Wolff, 'The Neglected Side of Banking Union: Reshaping Europe's Financial System', Bruegel Policy Contribution presented at the Informal ECOFIN Meeting in Vilnius (Bruegel, September 2013).

8 Mario Draghi, keynote speech at the Eurofi Financial Forum in Milan (European Central Bank, 11 September 2014).

9 This point was developed in the pre-crisis context by Thomas Philippon and Nicolas Véron, *Financing Europe's Fast Movers* (Bruegel Policy Brief 2008/01, January 2008).

system, and it exacerbated sudden stops and cross-border divergences in bank funding costs.

The articulation of the CMU's objective, however, has not been entirely clear so far. We suggest that the CMU agenda should aim to enable access by EU economic agents to the best-suited possible financing options, while safeguarding financial stability. This definition highlights major differences, in particular, with the banking union which is currently in a phase of implementation. The definition indicates that the CMU's focus is not the financial sector but the broader European economy. Stability concerns are not the primary driver, but only a check on the development of the CMU. Institutional issues are not at the core of the CMU project, even though institutional changes might be necessary to reach its aims. Its geographical scope is not centred on the euro area, but extends to the entire EU (see below). Last but not least, it is not triggered by crisis-management challenges, but is part of a broader long-term agenda of structural reform at the EU level. Banks play a vital part in capital markets, even in systems in which non-bank finance is comparatively more developed than in the EU. Thus, well-designed policies for banks and capital markets can be mutually reinforcing.

The CMU agenda connects with a long history of EU capital market building. Starting from the Treaty of Rome's expression of the freedom of movement of capital in 1957, major milestones on this historical path include the elimination of restrictions on capital movements in 1988; the Financial Services Action Plan of 1999,¹⁰ initiated in the wake of Europe's Economic and Monetary Union (EMU) and mostly implemented in the early 2000s; and the creation of European Supervisory Authorities (ESAs) in 2011, and new impetus given towards a 'single rulebook', following the Larosière Report of February 2009.¹¹ This historical continuity also suggests that, to deserve its labelling as a genuine 'union', the CMU agenda should go beyond the mere extension of pre-existing initiatives, even if these are important and helpful. It must envisage high-impact new steps that would trigger measurable progress towards its stated objective.

One important feature of the CMU, as framed by the European Commission, is that it should encompass the entire EU. The very notion of a single market for capital¹² aligns with the EU's internal market policy framework. Various analyses have identified specific benefits of CMU for the euro area, particularly in terms of risk-sharing.¹³ While these benefits are an important motivation for the CMU, they do not analytically imply that the project should or even could be executed at the euro-area level. On the contrary, the dominance of the City of London as Europe's capital markets hub (see next section) makes it impractical and undesirable to envisage a policy framework that would be limited to a subset of EU Member States. The UK government has welcomed the announcement of the CMU and signalled its intent

10 Commission, 'Financial Services: Implementing the Framework for Financial Markets: Action Plan' (Communication) COM (99) 232.

11 Commission, *Report of the High-Level Group on Financial Supervision in the EU Chaired by Jacques de Larosière* (Brussels, 25 February 2009).

12 See Benoît Coeuré, 'Completing the Single Market in Capital', speech at the International Capital Markets Association (ICMA) Capital Market Lecture Series in Paris (European Central Bank, 19 May 2014).

13 See eg Anderson and others (n 6); Coeuré (n 12); Martinez and Philippon (n 6).

to engage actively in its shaping,¹⁴ in sharp contrast with banking union, which the UK government also welcomed but on the condition of not taking part. Envisaging a CMU that would not include the UK or other non-euro-area Member States would be economically counter-productive.¹⁵

This article is intended as a contribution to the policy debate on the CMU. It presents facts about EU capital markets (section ‘Assessing the EU’s capital markets’), issues that should be taken into account in the development of CMU policy (section ‘Analytical takeaways’), corresponding policy options over the medium-to-long term (section ‘Policy agenda’), and suggestions for policy implementation and sequencing (section ‘Implementation and sequencing’).

ASSESSING THE EU’S CAPITAL MARKETS

When analysing financial intermediation and capital markets, three different perspectives are useful: the perspective of the demand for finance from corporations, households and governments; the perspective of financial intermediaries; and the perspective of asset owners such as savers or investors. All three perspectives are important in understanding differences in capital market structures in different jurisdictions. They are equally important in identifying the policy challenges the EU faces when promoting the development of capital markets.

The magnitude and composition of financial intermediation are substantially different in major economies. Figure 1 shows the EU’s large banking sector, while in the USA, debt securities and stock markets play a major role in financial intermediation. China’s financial system is still substantially smaller than the EU/US financial systems, while the structures of the Japanese financial system place it between the USA and EU.

The funding of the corporate sector is also substantially different in different jurisdictions. Only a part of the financial system serves to provide intermediation to the non-financial corporate sector, and the way the corporate sector is funded is substantially different in different jurisdictions (Figure 2). EU companies, like their Japanese counterparts, rely more strongly on bank credit, while US companies rely to a greater extent on equity financing, corporate bonds and securitization. In China, corporate credit markets remain comparatively underdeveloped.

One key feature that policymakers must keep in mind is that the structure of financial intermediation changes slowly. The way non-financial corporations fund themselves tends to be stable over time (Figure 3). In the USA, for example, the percentage of equity in total corporate funding has remained almost unchanged in the last 30 years. However, bank credit has become less important and was partly replaced by securitization (Figure 4). In both the UK and the euro area, equity

¹⁴ See, eg, quote from UK Chancellor George Osborne in Marion Dakers, ‘Europe Launches Blueprint for Capital Markets Union’ *The Telegraph* (19 February 2015) <<http://www.telegraph.co.uk/finance/news/bysector/banksandfinance/11420071/Europe-launches-blueprint-for-capital-markets-union.html>> accessed 24 April 2015.

¹⁵ The only qualification would be about some limited aspects of the CMU agenda on which the legal basis would require unanimity, and this would not be achievable across all EU Member States. Such aspects, eg proposals in the ‘Policy agenda’ section about taxation issues, might best be addressed through enhanced cooperation.

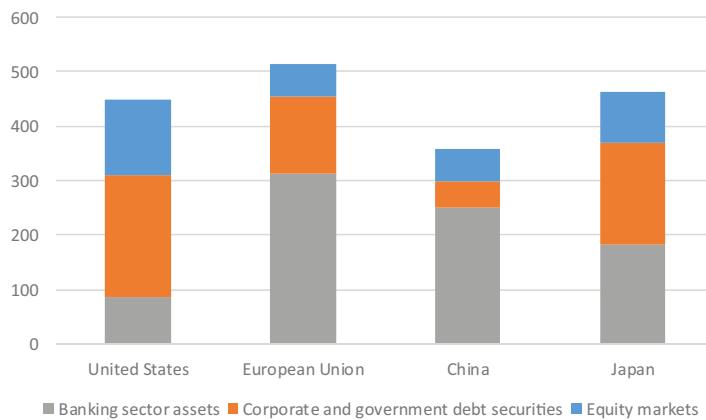


Figure 1. Size of the financial sector and capital markets (percentage of GDP).

Sources: Bruegel based on IMF World Economic Outlook, World Bank, Association for Financial Markets in Europe (AFME), Securities Industry and Financial Markets Association (SIFMA), Asian Bonds Online, China Banking Regulatory Commission, Board of Governors of the Federal Reserve System, ECB, Bank of Japan, China Statistical Yearbook, and World Federation of Exchanges.

Note: All data refer to end 2014 except EU: equity market (end 2012), Corporate and government debt securities (end 2013) and Japan: Banking sector assets (end 2013).

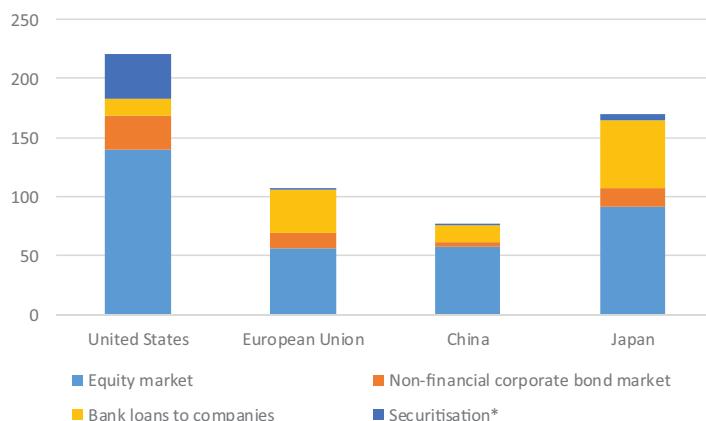
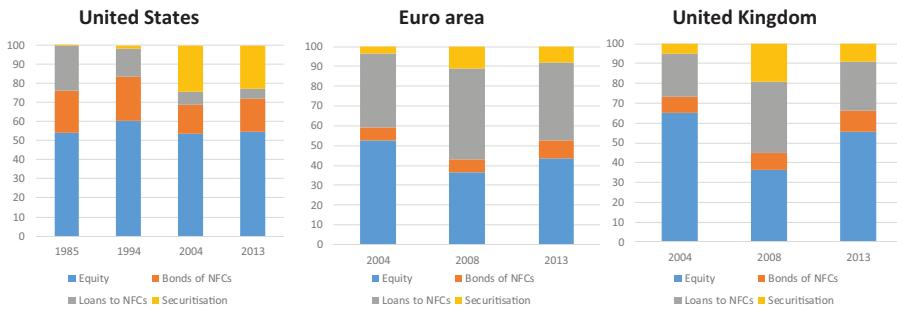


Figure 2. Size of financial intermediation to the non-financial corporate sector (percentage of GDP).

Sources: Bruegel based on IMF World Economic Outlook, World Bank, AFME, SIFMA, Asian Bonds Online, OPPLand Corporation, Board of Governors of the Federal Reserve System, ECB, Bank of Japan, China Statistical Yearbook and World Federation of Exchanges; *securitization is non-financial corporate sector in the USA (commercial mortgage-backed securities (CMBS)) and the EU (CMBS as well as SME securitization) and total securitization for China and Japan.

Note: Data refer to: USA: 2014; EU: 2013, except equity market (2012); China: 2014, except non-financial corporate bond market (2012) and bank loans to companies (2012); Japan: 2014.



Sources: US Bureau of Economic Analysis, Board of Governors of the Federal Reserve System, SIFMA, World Federation of Exchanges.

Sources: Eurostat, World Bank, AFME, ECB; Equity refers to 2012.

Sources: World Bank, Office for National Statistics, Bank for International Settlements, AFME, ECB; Equity refers to 2012.

Figure 3. Size of different financial intermediation channels to the non-financial corporate sector as share of total financial intermediation.

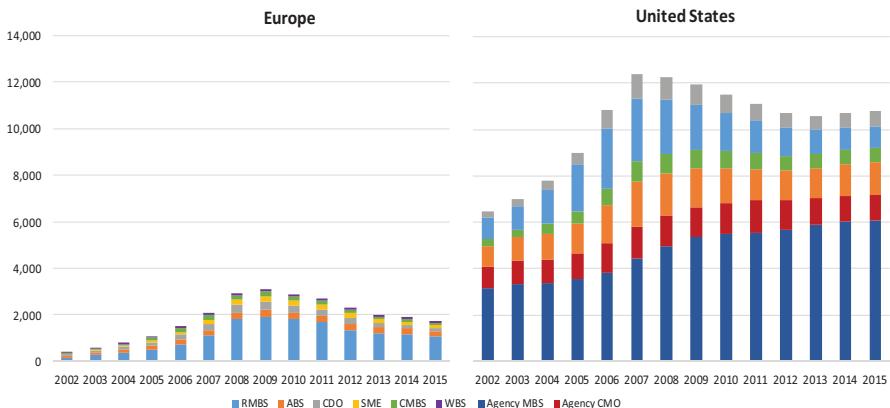


Figure 4. US and European securitization outstanding (US\$ billions).

Sources: SIFMA and Bruegel calculations.

Notes: European volumes include transactions from the European Economic Area (EEA) countries and certain non-EEA countries located on the geographic European continent (Turkey, Kazakhstan, Iceland, Georgia, and Russian Federation). Whole business securitizations (WBS), CMBS, small- and medium-sized enterprise securitizations (SME), other asset-backed securities (ABS) collateralized debt obligations (CDO), residential mortgage-backed securities (RMBS), Agency collateralized mortgage obligations (Agency CMO), Agency mortgage-backed securities (Agency MBS); 2015 refers to 2015Q2.

financing has gradually lost importance, while bank lending became significantly more important until the beginning of the crisis.

There are also substantial differences in the funding models in different EU countries, with bank lending, securitization, corporate bonds, and equity playing very different roles (Figure 5).

Moreover, the EU financial system remains national, and cross-border financial integration is still limited in spite of past single market policy initiatives. Retail banking has remained largely national with very few cross-border loans and limited cross-border ownership of subsidiaries, depending on the country (Figure 6).

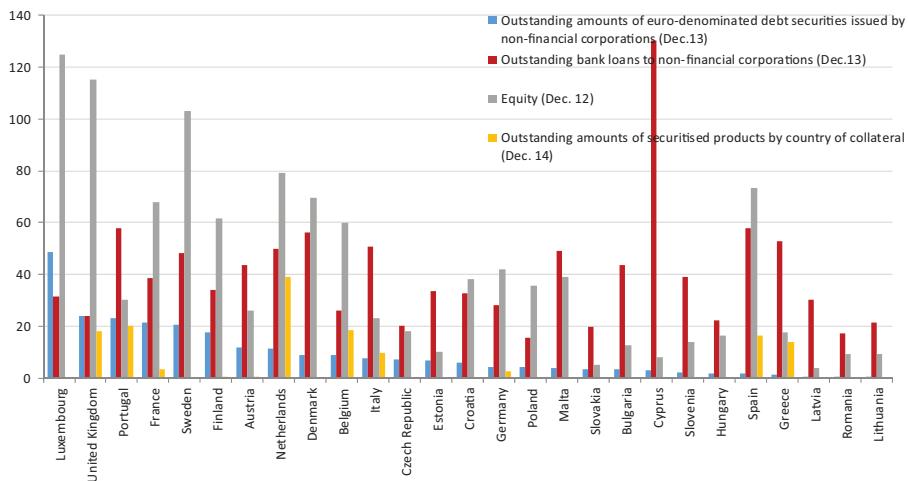


Figure 5. Breakdown of financing channels by EU country (as a percentage of the respective country's GDP).

Sources: ECB, World Bank, AFME.

Note: 'Equity' is defined as market capitalization of listed companies; data were transformed using the GDP of the respective period.

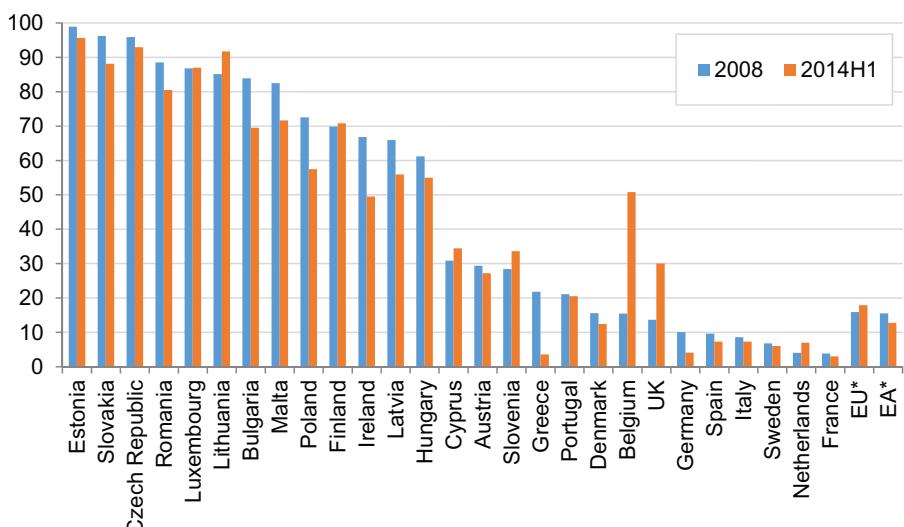


Figure 6. Share of assets held by foreign banks (in percentages).

Source: ECB.

Note: Foreign banks are defined as subsidiaries and branches that are controlled by either an EU or a non-EU parent that is 'foreign' from the reporting country's point of view. * Changing composition.

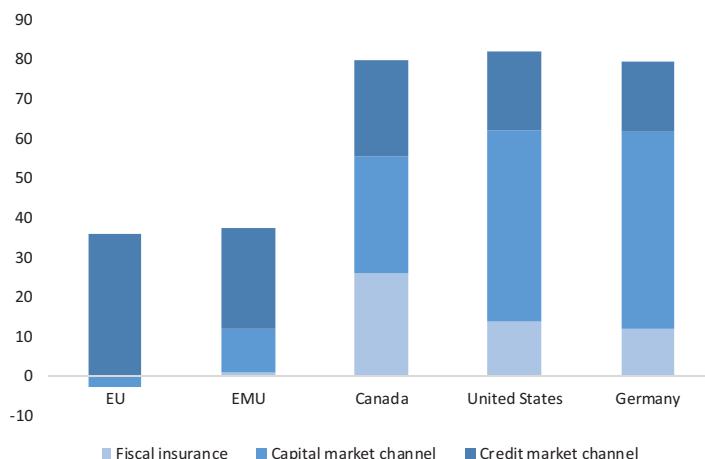


Figure 7. Risk sharing (percentage of shock smoothed by the different channels).

Source: IMF (2013).

Wholesale banking became integrated before the crisis but has since lost its cross-border importance. Cross-border corporate bond holdings declined substantially during the crisis, but recently increased again. Also, the home-bias in equity remains substantial, with 64 per cent of EU equity holdings and 61 per cent of Euro area (EA) equity holdings being of domestic origin.

Capital markets can play an important role in spreading economic risk across different regions and jurisdictions. A substantial body of literature provides evidence that well-integrated and deep capital markets can spread country and region-specific risk, thereby smoothing the impact of deep recessions on consumption and investment (Figure 7).¹⁶ Such economic risk sharing requires substantial cross-border equity holdings in particular.

Funding models are not only determined by the behaviour of corporations but also by the behaviour of savers. When savers invest significant amounts of their savings in equity, then funding with equity becomes easier for corporations. Conversely, if savers put their money mostly into bank deposits, banks tend to play a greater financial intermediation role. EU households predominantly save in deposits while US households predominantly save in shares, life insurance and pension funds. Figure 8 shows that EU households save much less in bonds, stocks and insurance than US households. Instead, they have more than 40 per cent of their financial wealth in the form of deposits. Also, the level of financial wealth is very different in the EU and the USA. As of 2012, the average household in the EU15 (before the 2004

¹⁶ See Bent E Sorensen and Oved Yosha, 'International Risk Sharing and European Monetary Unification' (1998) 45 Journal of International Economics 211–38; Céline Allard and others and an IMF Staff Team, 'Toward a Fiscal Union for the Euro Area', International Monetary Fund Staff Discussion Note SDN/13/09 (September 2013); Commission, 'Initial Reflections on the Obstacles to the Development of Deep and Integrated EU Capital Markets', Staff Working Document SWD(2015)13 accompanying the Green Paper (Brussels, 18 February 2015).

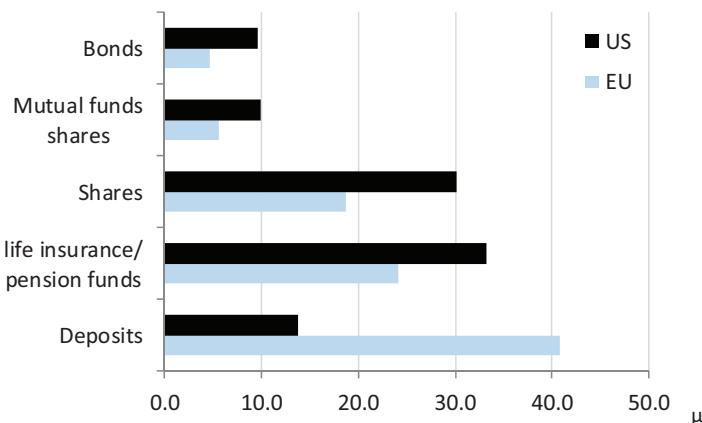


Figure 8. Financial portfolio of households in the EU and USA (in percentage of total financial assets).

Source: OECD, 2011.

enlargement) held €39,160 in net financial wealth, while the average US household held €110,227. The different savings patterns give banks a greater role in financial intermediation in the EU than in the USA.

These different savings patterns also have important implications for maturity transformation. The maturity structure of savings in the USA and the EU is substantially different: US savers invest a much larger share of their savings in assets with long maturities, including equity, life insurance and pension funds, while EU savers invest in instruments that are easily accessible such as deposits. As a consequence, the financial system has to provide different levels of maturity transformation in the different jurisdictions if it wants to achieve the same funding structure of corporates.

It is often mentioned in policy debates that more than 65 per cent of EU employment and more than 55 per cent of EU value added is contributed by small- and medium-sized enterprises (SMEs). But rather than SMEs in general, it is young, high-growth companies that play the central role in EU job creation. According to OECD research, about half of all new jobs are created by young firms, and these young firms have always been net job creators throughout the business cycle (with high-growth firms playing the most important role), even during the financial crisis.¹⁷ Hence, if creating jobs is a key goal, the financing and growth of such young, high-growth firms is a central challenge for the EU.

SMEs predominantly rely on bank lending for their funding (Figure 9). To the extent that bank lending is a constraint because of limits to banks' balance sheets, securitization could free up additional lending. The securitization market for SMEs is particularly strong in Spain and Italy. However, it serves more to create assets eligible for the collateral operations of the ECB than to free up banks' balance sheet capacities. Most of the newly issued securities are retained (Figure 10). Developing a more dynamic market for creating and placing SME credit as securities could be a helpful

¹⁷ Chiara Criscuolo, Peter N Gal and Carlo Menon, *The Dynamics of Employment Growth: New Evidence from 18 Countries* (Organisation for Economic Co-operation and Development, Paris, 21 May 2014).

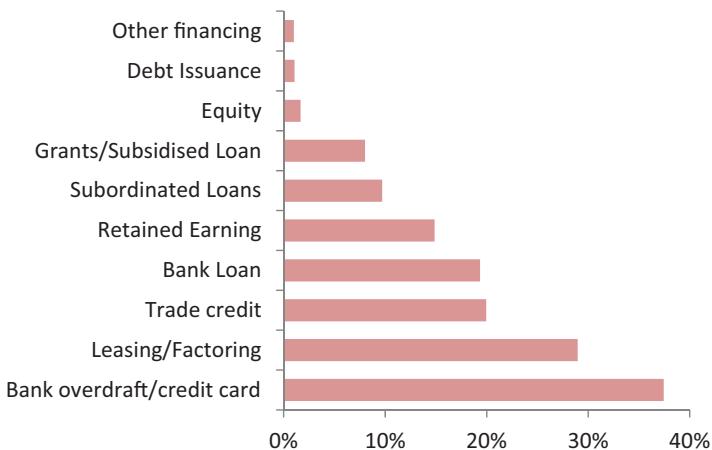


Figure 9. Sources of SME financing in the past 6 months (percentage of EU28 SMEs).

Source: European Central Bank, SAFE 2015 (wave 13).

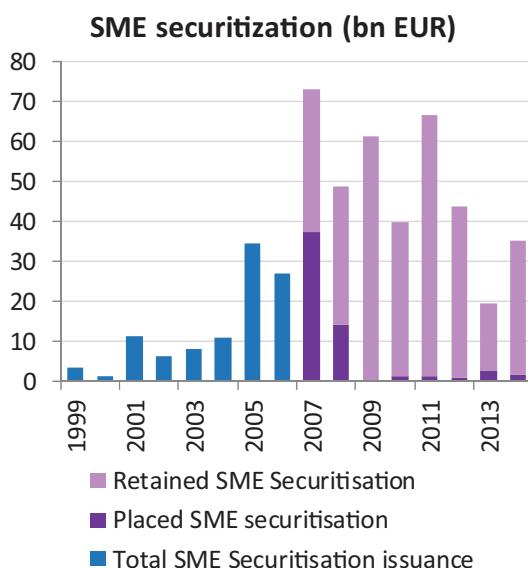


Figure 10. European SME securitization issuance by retention (in EUR billions).

Source: AFME.

Note: Since 2007, the total issuance can be split between 'retained' and 'placed', where 'placed' refers to securitizations placed with investors on the primary market and 'retained' refers to securitizations retained by banks to create liquidity buffers and to access ECB liquidity.

avenue to improve funding for SMEs. Realistically, however, this would only make a difference for a minority of larger SMEs, given the idiosyncratic nature of SME credit risk and the cost of documenting securitization. Beyond securitization, service innovators that do not have tangible collateral to pledge need access to high-risk forms of credit such as mezzanine and high-yield debt, which are typically not offered by traditional banking.¹⁸

Another dimension of the CMU debate is about the impact on financial centres. It is well established that financial services tend to concentrate in hubs. In the EU in particular, wholesale financial activity is already highly concentrated in London, and if anything, the recent years of crisis appear to have accelerated the concentration because banks have been forced to restructure their less-efficient activities. A recent survey suggests that 77 per cent of highly paid financial executives in the EU are based in the UK. The next most significant group is in Germany, representing only 6 per cent of the total.¹⁹ Similarly, the UK's share of total derivatives transactions in the EU rose from 61 to 77 per cent in the 15 years to 2013 (London's share in the global total also rose during this period, from 33 to 43 per cent). As of 2013, the next largest share in the EU was France's, at only 7 per cent of the EU total.²⁰

ANALYTICAL TAKEAWAYS

Because the structure of financial systems changes slowly, the CMU should not be seen as a 'quick fix' substitute for repairing the bank-lending channel where still needed. To revive economic growth and investment in the short term, policymakers are right to rely on ECB monetary policy measures, including the quantitative easing programme started in March 2015; on the work by the European Single Supervisory Mechanism and Single Resolution Board to repair banks' balance sheets and achieve a return of trust to Europe's banking sector; and on initiatives to boost investment, such as the Juncker investment plan at the EU level and national confidence-building measures. Even though an assessment is not within the scope of this article, these actions all have growth- and job-boosting potential in the short-term. By contrast, hopes that the CMU would play a meaningful role in EU economic recovery from the crisis are likely to be disappointed.

The CMU should be designed and thought of as structural and long-term transformation of financial intermediation in the EU. It cannot serve as a short-term stimulus to boost finance. Rushing it through subsidies or tax or regulatory privileges will be distorting and ultimately counter-productive and should be avoided. What counts is to create the right framework conditions so that the new financial ecosystem can develop at its own pace, which will be gradual.

The two objectives of enhancing capital markets development and of fostering cross-border financial integration are distinct and might require different policies. Europe's financial system can be characterized by two fundamental features. First, capital market finance is comparatively underdeveloped in most countries given their

18 This point is further developed in Philippon and Véron (n 9).

19 European Banking Authority, *Benchmarking of Remuneration Practices at Union Level* (London, June 2014).

20 Bruegel calculations based on the Triennial Central Bank Survey of foreign exchange and derivatives market activity in 2013 <<http://www.bis.org/publ/rpfx13.htm>> accessed 24 April 2015.

general level of economic development. Secondly, financial markets still remain predominantly national, as measured by high home bias in investment patterns. The two issues are linked but call for different policies. While the response in the first case should be to improve conditions for capital market intermediation in every country, the second issue should be addressed by harmonizing and standardizing the national financial intermediation rules and practices.

The CMU should combine the benefits of deepening and integrating financial markets. Both are beneficial and mutually reinforcing. Integration across borders, not least in equity markets, brings economic risk mitigation and reduces the financial-sovereign vicious circle. It also increases competition and allows for scale effects, which should help to generally reduce funding costs. This integration will also contribute to the development of markets. Deeper capital markets, in turn, offer a greater variety of funding options and easier access to finance for different kinds of corporations. They also increase the options for households to save and invest.

Most SMEs will remain reliant on banks for their external funding and will not be directly impacted by the CMU. However, the CMU should have a material impact to broaden financing options for high-growth companies of all sizes and dynamic medium-sized firms. It is misleading to characterize CMU as a project to target primarily SMEs. SMEs will continue to rely predominantly on banks, even though larger SMEs might gain capital market access through better-developed corporate loan securitization. Large corporations already have decent access to capital markets. Where the CMU offers the most potential is for high-growth companies, which lack access to risk capital²¹ and for medium-sized companies, which currently have much more limited access to capital markets than large groups.

To boost the role of capital markets in financial intermediation, the perspectives of savers, financial intermediaries and non-financial firms are all important. The shape of the financial ecosystem depends on decisions taken by all three categories and the framework conditions that affect them. Changes in the funding mix for non-financial corporations have implications for financial intermediaries as well as for savers. For example, strengthening equity funding implies that investors need to accept higher risk and longer maturities. While the current pattern of European savings in low-risk, short-maturity instruments is probably rooted in preferences and demographic structures, it is also encouraged by specific tax and regulatory policies. These policies should be amended to further the objective of better funding for the European economy, including through equity instruments. Similarly, corporate governance and ownership patterns that are dominated by family control in several EU Member States might contribute to companies' reluctance to tap external sources of finance, especially those outside banks. But a more favourable policy framework could incentivize a significant number of companies to change their financing patterns in a manner that would be more conducive to investment and job creation. Financial intermediation and in particular banks are also central. Banks perform important functions in terms of maturity transformation, financial engineering and the overcoming of information asymmetries, and they have the capacity to deal with

21 Reinhilde Veugelers, *Mind Europe's Early-Stage Equity Gap* (Bruegel Policy Contribution 2011/18, December 2011).

regulatory and supervisory differences between countries. Increasing harmonization across EU countries could allow other organizations or even savers to engage directly in cross-border activity more easily. However, this also means that non-banks take certain risks, including in terms of maturity transformation.

Deeper and more integrated capital markets should spread economic risk, but potential financial stability risks need to be managed. The economic literature and the empirical evidence are clear that financial integration is a good way to spread economic risk. But the emergence of new financial players also raises financial stability concerns, especially when they engage in maturity transformation and/or financial engineering. There are risks at the level of instruments, institutions and the system. While not identical to those from banking, financial stability risks from capital markets and non-bank finance need to be adequately monitored and, if necessary, mitigated through appropriate regulation. Thus, financial stability considerations should be an integral part of CMU. This raises questions about regulation, supervision and resolution, and the allocation of these tasks to relevant institutions.

To achieve a different pattern of household investment, protection of savers is fundamental. Households and savers will only invest in financial products if they are transparent and comply with clear and reliable rules. Deposits in the EU enjoy the extraordinary privilege of a high deposit insurance guarantee. By contrast, other forms of financial investment have much more limited protection if any, and are often opaque and difficult to understand. Adequate safeguards for savers and investors should, therefore, be an important part of the CMU and might require a strengthening of both legislation and supervision. Consumer protection also needs to be adequately calibrated so that it does not stifle risk taking and innovation.

All Member States will gain from better access to finance and better returns for savers, even though some will host more financial-sector activity than others. In an integrated market, financial firms tend to concentrate in a limited number of locations, especially in terms of wholesale market activity. The US financial system, for example, is dominated by the role of New York and a few other spots such as Boston, Chicago, and the San Francisco Bay Area. Yet, Texas or Ohio can still prosper without a capital market of their own, or even locally headquartered large banks. There are only three stock exchanges in the USA, as opposed to 13 in the EU.²² Similarly, CMU does not mean that all Member States have to gain in terms of the development of their own financial services sectors. On the contrary, comparative advantage should be allowed to play its role. From this perspective, the CMU would have a distributional impact on EU Member States, given the different strengths of their comparative advantage in financial services. This distributional impact of CMU, however, should not shift attention from its more significant impact on non-financial corporate funding and improved saving opportunities, which would be positive in all

²² Based on membership of the Federation of European Securities Exchanges (FESE) and the World Federation of Exchanges (WFE). These groups are, respectively, BATS, Nasdaq and the New York Stock Exchange (part of ICE) in the USA; and the stock exchange groups headquartered, respectively, in Amsterdam (Euronext), Athens, Bucharest, Bulgaria, Cyprus, Frankfurt (Deutsche Börse), Ireland, Luxembourg, Madrid, Malta, Stockholm (part of Nasdaq OMX), Vienna (CEE Stock Exchange), and Warsaw in the EU. This list does not include the separate stock exchanges in Bratislava and Zagreb, which do not appear on the FESE membership list.

Member States even though the magnitude would vary. Local financial ecosystems now work through private equity and investment communities, not local financial infrastructure such as stock exchanges. To reap efficiency gains, the CMU should be allowed to disrupt currently protected national infrastructure platforms and other entrenched financial market structures.

The CMU goes beyond a narrow definition of financial services policy. Financing patterns are determined not only by securities, conduct, and prudential rules that are specific to the financial sector, but also by other policies that shape the behaviour of companies, savers, and financial intermediaries, such as those that govern the sharing of information and data, insolvency frameworks, and tax policies. This broad scope is reflected in the policy proposals detailed in the following section.

POLICY AGENDA

The following recommendations are based on the analytical framework presented in the previous section, and on the current stage of development of capital markets policy in the EU. They also follow extensive discussions with a wide range of stakeholders²³ and a review of available surveys and evidence. It is not implied that all the following items must be delivered in full for the CMU to be a long-term success, nor indeed that this list is exhaustive—other significant initiatives may be needed, possibly in the wake of new technological developments. Nevertheless, these items all appear important if the goals of the CMU as expressed by the European Commission and tentatively defined in this article's introduction are to be met.

First, the EU should enhance its system-wide surveillance. Most EU Member States have a long tradition of monitoring risks in their national banking systems. In the euro area, the implementation of the banking union offers the prospect of much-improved supranational banking risk monitoring. However, the surveillance of a more complex financial system in which the role of banks could gradually become less dominant implies new challenges, which call for an adequate infrastructure.²⁴ This echoes legitimate concerns about 'shadow banking' and the possibility of financial risks migrating to parts of the financial system where they might escape public monitoring. New initiatives are needed both on data collection, which currently tends to be fragmented across different systems, and on institutional architecture, a particular challenge given the strong interdependencies between the euro area (which accounts for a majority of the EU's economy), the UK (which hosts the main hub of EU capital markets) and other non-euro Member States. One solution might be to beef up the capacity of the European Systemic Risk Board (ESRB) to collect and analyse granular data and thus to bring Europe closer to the vision of a holistic

23 These included a brainstorming workshop held at Bruegel on 24 November 2014, a presentation by the authors at a meeting of the EU Financial Services Committee on 20 January 2015, participation of the authors and their Bruegel colleagues in a range of conferences and other events organized by third parties in a number of different EU Member States, and numerous bilateral conversations with interlocutors in academia, the public policy community, the private sector and other segments of European civil society. The authors are also grateful to all those who have given feedback on early drafts of this article.

24 Among others, Wright (n 6) notes that 'there is a striking inconsistency in data in some parts of the [EU] capital markets'.

real-time ‘risk map’,²⁵ in conjunction with efforts led by the Bank for International Settlements (BIS) and Financial Stability Board (FSB) at the global level.

Secondly, the EU should consider additional financial regulatory initiatives. In the wake of earlier efforts to move towards a single rulebook for capital markets regulation, the EU should continue to work towards a clearly articulated, simple, and effective regulatory framework for those financial market activities that cannot simply be left to the discipline of the markets. This should include the completion of projects that have already been announced or are at various stages of development by the European Commission and other EU institutions, including on European long-term investment funds (ELTIFs),²⁶ securitization,²⁷ the revision of the Prospectus Directive²⁸ and private placements.²⁹ It should also include additional initiatives such as a revision of the EU framework for Undertakings for Collective Investment in Transferable Securities (UCITS), the reference fund status for retail investment in the EU, in order to enable direct investment by UCITS in loans originated by banks, because the current curbs on such investment appear excessive from the standpoint of both financial stability and investor protection. The EU should also further replace directives with regulations to close loopholes, reduce national ‘gold plating’ (the addition of idiosyncratic national provisions in the legislative transposition of EU directives) and ensure pan-EU regulatory consistency. Such regulatory actions form the bulk of the concrete policy proposals described in the European Commission’s green paper on the CMU. It should however be kept in mind that while necessary, these measures would be far from sufficient to enable significant development and integration of EU capital markets.

In addition to the regulation of financial products and activities, many financial firms are subject to specific regulatory, supervisory and in some cases resolution frameworks that impact on their role in the development of EU financial markets. Such regulation is generally motivated by concerns about financial stability, given the specific nature of financial systemic risk, and/or about financial conduct, not least because of the multiplicity of information asymmetries that exist in finance. In this respect, legislation currently under discussion on banking structural reform is of particular importance.³⁰ The detailed study of this project is beyond the scope of

25 See eg Otmar Issing and Jan Krahnen, ‘Why the Regulators must have a Global ‘Risk Map’, *Financial Times* (18 February 2009).

26 The European Commission published a legislative proposal on ELTIFs in June 2013, which is currently going through the EU legislative process.

27 Commission, ‘Proposal for a Regulation of the European Parliament and of the Council Laying down Common Rules on Securitisation and Creating a European Framework for Simple, Transparent and Standardised Securitisation and Amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012’ COM (2015) 472.

28 Commission, ‘Regulation of the European Parliament and of the Council on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading’ COM (2015) 583 final.

29 See a proposal outline for a harmonized single EU private placement regime in Alan Houmann and Simon Gleeson, ‘What would Constitute an Effective Capital Markets Union for the EU?’ (2016) mimeo.

30 Commission, ‘Proposal for a Regulation of the European Parliament and of the Council on Structural Measures Improving the Resilience of EU Financial Institutions’ COM (2014) 43; European Council, *Restructuring Risky Banks: Council Agrees its Negotiating Stance* (Press Release) <<http://www.consilium.europa.eu/en/press/press-releases/2015/06/19-restructuring-risky-banks-council-agrees-negotiating-stances/>> accessed 24 April 2015.

this article. However, it would seem appropriate to take into account the CMU's objective of capital markets development in the legislative finalization of this text. Other significant bank-related regulatory projects with significant implications for capital markets include further EU implementation of the global Basel III Accord, and the future EU implementation of the new global standards on banks' total loss-absorbing capacity (TLAC).³¹

Aside from banks, insurers are crucial participants in European capital markets as investors. The implementation of the new Solvency 2 regime was completed in early 2016. However, this package deters investment by insurers in riskier market segments such as equities, under a framework that is largely inspired by the prudential regulation of banks and does not adequately take into account the longer maturities of insurance liabilities. EU legislators should consider rapid review of Solvency 2 in order to achieve a better balance between the need to maintain the long-term solvency of insurers and the concern not to unnecessarily hamper their potential as long-term risk-taking investors in the European economy. Also, the EU should consider adjustments to regulations that were adopted in the heat of the crisis—for example, those on alternative investment funds and on credit rating agencies—in order to take into account the impact of their early implementation on EU capital markets activity.³²

One category of intermediaries that European policymakers have often tried to actively promote is venture capital (VC) funds. The development of VCs is seen as desirable because it is associated with high-growth technical innovators. However, the record of policies aimed at stimulating VC development through provision of public money, either in the form of public VCs or co-investment of public funds with private-sector VCs, is not compelling. The main reason is that the control mechanisms that are inherent in any use of public funding easily enter into conflict with the high-risk, high-return logic of VC investment, including the way VC investments are chosen, and even more so the way they might be discontinued when the company receiving investment is not sufficiently successful. In addition, the injection of significant amounts of public money into comparatively small VC markets in individual Member States has often led to market and price distortions which have ended up penalizing rather than helping the most innovation-oriented VCs. Thus, the EU should refrain from throwing public money at the VC market, including though the European Investment Fund (EIF). The best way to encourage a vibrant European VC industry is to work on their investment environment rather than interfere directly with their activity. Our proposals, below, should contribute to such an approach, because they focus on the framework conditions in which capital markets can develop.

Thirdly, the EU should envisage institutional changes to achieve more consistent and better regulatory implementation and enforcement. Overwhelming evidence from market participants suggests that the current regime of national implementation and enforcement of even the most-harmonized EU regulations results in diverging practices and market fragmentation. Companies and investors cannot simply

³¹ Financial Stability Board, *Total Loss-Absorbing Capacity (TLAC) Principles and Term Sheet* (9 November 2015).

³² The European Commission has conducted a consultation on the cumulative impact of recent financial legislation, see European Commission, 'Call for Evidence EU Regulatory Framework for Financial Services', 2015.

transpose their experience of regulations in one Member State to another, and need country-specific legal advice in each Member State. In a 2015 survey, investors cited the complexity of such differences and the discrepancies between rules (resulting from national rules and from gold-plating of EU laws) as the two most important barriers to investment in the EU.³³ The creation of the European Securities and Markets Authority (ESMA) in 2011 provides an existing infrastructure for the implementation and enforcement of EU legislation in a consistent manner, but ESMA needs to be further empowered to act as an effective regulator rather than a weak co-ordination mechanism. In the early stages of the CMU debate, the chairman of ESMA noted that 'Given the breadth and complexity of the single rulebook, regulators need to make many choices regarding their supervision, including the interpretation of the rules and the intensity of supervision. Diversity in these choices will have the result that the single rulebook will not in fact be seen as such by investors and market participants.'³⁴ An EU Court of Justice ruling in 2014 provided additional legal security on the granting of authority to ESMA on matters of capital markets regulation³⁵ and ESMA is already the sole supervisor for certain categories of capital market participants, including credit rating agencies and trade repositories.

Specifically, the authority to approve new securities issuance and to authorize funds under legislation such as UCITS and Alternative Investment Fund Managers (AIFM) may be transferred to ESMA, with a transfer back to national authorities of much of the actual regulatory work but as part of a binding EU network in which ESMA would have effective policy control.³⁶ Other areas, such as EU competition policy and (in the euro area) the prudential supervision of banks within the Single Supervisory Mechanism, provide examples of such patterns of delegation that ensure both regulatory consistency and a large degree of operational decentralization.

Similarly, the enforcement of EU capital markets regulation should be at least partly pooled at the level of ESMA with wide operational delegation back to the national authorities, in order to ensure that sanctions for non-observance are not simply evaded by market participants by moving their activity from stricter to more lenient EU jurisdictions (a practice often described as 'forum-shopping'), for example, in relation to rules on securities issuance and investor protection. Similarly, obligations related to system-wide risk monitoring, including the requirement to report derivatives transactions to central repositories, are currently enforced very differently in different Member States, and a transfer of enforcement responsibility to ESMA would result both in lower costs and in much improved compliance. The possibility of coexistence of national and European enforcement regimes should be carefully assessed, but must not be considered an intractable problem *per se*. The long-standing

33 AFME (2015a) as above, *Figure 1*.

34 Steven Maijor, 'Regulators, Pension Funds and Efficient Financial Markets', speech at the National Association of Pension Funds (NAPF) Investment Conference in Edinburgh (European Securities and Markets Authority, 12 March 2015).

35 Judgment of the Court in case C-270/12, UK vs Parliament and Council, 22 January 2014, analysed eg in Jacques Pelkmans and Marta Simoncini, *Mellowing Meroni: How ESMA can Help Build the Single Market* (Centre for European Policy Studies, 18 February 2014).

36 Both proposals, referred to as a 'European System of Listing Authorities' and a 'European System of EU Fund Approval', respectively, are in Houmann and Gleeson (n 29).

situation in the USA in which federal and state-level enforcement frameworks operate simultaneously, especially in states with significant financial activity such as New York, shows that such coexistence can be managed. In parallel, the Commission should be more assertive in its task of single market enforcement through infringement procedures when needed, in cases of national legislation that is not compliant with the EU framework.

Of course, such regulatory centralization would require decision at the appropriate political level, as was the case when the decision to create ESMA and the other ESAs was made in June 2009. It would also probably entail reform of ESMA itself. Section 'Implementation and sequencing' further discusses some of the related challenges.

One area which is particularly ripe for an EU institutional overhaul is that of accounting and auditing. Financial information has been justifiably described as the life-blood of capital markets,³⁷ and the availability of high-quality and comparable financial information on issuers across the EU is a crucial condition for the success of the CMU. The EU's adoption of International Financial Reporting Standards (IFRS), decided in 2002 and implemented in 2005–06, was a huge step in this direction, but more needs to be done. There remain wide differences between Member States in IFRS implementation and enforcement and in other aspects of financial disclosure. Two main reforms should be considered in this area.

Responsibility for IFRS enforcement should be granted to a newly created office of the European Chief Accountant (in reference to the equivalent authority in the USA, which is hosted by the Securities and Exchange Commission). This office, which could be envisaged either as part of ESMA or as a new organization, would be given functional authority over the existing national competent bodies³⁸ for the purposes of IFRS implementation. Separately, the numerous loopholes that exist in EU auditing legislation (including after its latest revision in 2014) should be closed to constitute a genuine single rulebook, and the supervision of audit firms should be pooled at the European level in a specialized agency that could be subject to oversight by ESMA (in a relationship similar to that between the US Public Company Accounting Oversight Board and the Securities and Exchange Commission).

In addition, the European Commission should further explore the costs and benefits of reforming accounting obligations that are not currently within the scope of IFRS, namely the financial statements of individual entities and of unlisted companies. While there might be a case for harmonization,³⁹ this should be robustly assessed on the basis of the subsidiarity principle. It should also be considered in liaison with proposals to reform corporate taxation, because tax accounting is one of the main drivers

³⁷ See eg Arthur Levitt, 'Quality Information: The Lifeblood of Our Markets', speech at the Economic Club of New York (US Securities and Exchange Commission, 18 October 1999).

³⁸ Depending on national circumstances, these are currently either accounting enforcement units within securities regulators (as in France, Italy, the Netherlands and Spain), or hosted by other specialized public authorities (eg the Financial Reporting Council in the UK), or private-sector bodies empowered by law (eg the Financial Reporting Enforcement Panel in Germany).

³⁹ For example, Maijor (n 34) argues that 'we should consider moving to a common accounting language for SMEs that would like to grow and get a broader investor base. That language should be based on IFRS but not as extensive as the standard set of IFRS.'

of non-IFRS financial reporting in many if not all EU Member States: a move towards harmonization of the corporate income tax base would have obvious spillovers in terms of harmonization of single-entity accounting requirements.⁴⁰

Alongside financial information covered by accounting and auditing frameworks, information about corporate risk and credit is similarly important in order to stimulate market-based investment. Even though situations differ in Member States, capital market participants in the EU other than banks and central banks currently have only limited access to credit information about SMEs and even many large companies (aside from the limited number that are rated by credit rating agencies). The European Commission has started work on improving the availability and quality of such information, as announced in the CMU green paper. But this raises complex issues of confidentiality and market structure, and should also be connected with the ambitious ECB project of building an analytical credit dataset (known as AnaCredit) which would also cover a large part of the SME credit landscape.⁴¹

Fourthly, the EU should act to better integrate its financial infrastructure. As noted in the previous section, the European landscape for trading and post-trading infrastructure is marked by extraordinary complexity and fragmentation. This is due in large part to the complex legacies of past national systems, and also to the lingering symbolic potency of stock exchanges as emblems of national economic strength and sovereignty. In the early 2000s, the European Commission promoted a strategic review that resulted in two landmark reports by a group chaired by Alberto Giovannini and identified 15 'Giovannini barriers' to efficient cross-border clearing and settlement in the EU. Even after initiatives including the adoption in 2014 of a new EU Regulation on Central Securities Depositories and the creation by the ECB of the Target2-Securities (T2S) platform for securities settlements, many of these barriers still remain.⁴² As identified in the Giovannini reports, the EU should aim to reduce or eliminate the current difference between cross-border securities transactions and transactions within a single EU country. The specific but systemically important challenge posed by the prudential supervision of derivatives clearing houses (known in the EU as central counter-parties (CCPs)) is discussed in the next section.

Fifthly, the EU should foster reform of national insolvency and financial restructuring frameworks. A growing literature has identified insolvency law and debt-restructuring practices as major determinants of corporate credit.⁴³ In the EU, the

⁴⁰ It should be noted however that the current EU project for a Common Consolidated Corporate Tax Base (CCCTB) would be only an option for companies, and its adoption would thus not have an obvious impact in terms of accounting frameworks.

⁴¹ See eg Violetta Damia and Jean-Marc Israël, 'Standardised Credit and Credit Risk Data' (Seventh Irving Fisher Committee (IFC) Conference, Basel, Bank for International Settlements, 4–5 September 2014).

⁴² See, in particular, <<https://www.ecb.europa.eu/paym/t2s/about/about/html/index.en.html>> accessed 24 April 2015 and <<https://www.ecb.europa.eu/paym/t2s/about/html/giovannini.en.html>> accessed 24 April 2015 for a description by the ECB of the complexity of clearing and settlement, the Giovannini barriers, and the expected impact of T2S.

⁴³ See eg Simeon Djankov, Caralee McLiesh and Andrei Shleifer, 'Private Credit in 129 Countries' (2007) 84 *Journal of Financial Economics* 2; Sergei A Davydenko and Julian R. Franks, 'Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany and the UK' (2008) 63 *Journal of Finance* 2; and Guillaume Plantin, David Thesmar and Jean Tirole, 'Les enjeux économiques du droit des faillites', *Conseil d'Analyse Economique* (Paris, June 2013).

understanding of this issue has been recently enhanced by observation of significant insolvency reforms in countries under assistance programmes, such as Ireland. A better insolvency framework allows for a better re-allocation of capital and more growth. In many EU Member States, inefficient and antiquated frameworks for insolvency and debt restructuring deter corporate investment and high-risk segments of credit (such as mezzanine and high-yield debt), because investors and creditors are insufficiently protected in case of insolvency, and the conduct of the insolvency process fails to maximize the prospects for asset recovery. Additional inefficiency arises from the lack of consistency of insolvency provisions across borders, but the first-order issue appears to be the inadequacies of national insolvency frameworks in terms of the laws themselves and the way they are implemented through courts and the work of specialized service providers and professions. In this area, full harmonization is unrealistic even over the long-term, given deeply embedded differences in national legal frameworks. However, the EU could stimulate a coordinated reform process with common principles and harmonization of a limited set of relevant aspects,⁴⁴ with appropriate benchmarking and monitoring at the EU level. This might be achieved in a legislative proposal for insolvency law harmonization, which the European Commission has announced it will publish before the end of 2016. In parallel, the creation of a specific EU insolvency regime for banks, administered by an EU court, appears indispensable in the medium term to complete the legal framework of banking union and especially the vision of a Single Resolution Mechanism.⁴⁵

Sixthly, the EU should reform and at least partly harmonize the taxation of savings and investment. Since taxation always acts as a key driver of investor behaviour, differences in frameworks for the taxation of savings are a contributor to market fragmentation and to the difficulty of creating powerful, simple, pan-European market segments for investment. In many Member States, tax frameworks also contribute to the orientation of savings towards low-risk, short-maturity instruments. Because EU-wide unanimity is likely to be unattainable, joint projects for the taxation of savings could be envisaged by subsets of Member States using the enhanced cooperation procedure. This procedure has already formed the basis for the initiative to create a European financial transactions tax (FTT), but unfortunately this project still appears ill-designed. Protracted discussions over the FTT and, if eventually adopted, its implementation might act as a brake on investment, with detrimental economic consequences. EU Member States should instead focus their energies on harmonized taxation of savings, reforming the tax disadvantage given to equity relative to debt, and other initiatives that could stimulate investment and market development.

While the above list of proposals might be considered ambitious, it is not intended to be exhaustive. In particular, reforms of pensions and housing policies could have a very significant impact on capital markets, for example, with the creation of pan-European pension fund systems or covered-bond markets. However, these developments would have social and political implications far beyond concerns about

⁴⁴ See a recent set of proposals in AFME, *AFME Proposes Changes to European Insolvency Laws in a Letter to the European Commission* (Press Release, 7 April 2015).

⁴⁵ Nicolas Véron, *Europe's Radical Banking Union* (Bruegel Essay and Lecture Series, May 2015).

capital markets development. Consequently, we consider them to be beyond the remit of the CMU agenda. However, CMU-related aspects may usefully be considered in relevant future discussions.

IMPLEMENTATION AND SEQUENCING

In its September 2015 action plan, the European Commission has chosen to emphasize the delivery of 'quick wins' on ongoing projects of financial product regulation, particularly securitization and the prospectus directive. But these will be no substitute for more ambitious initiatives with transformative long-term impact that would justify the CMU's 'union' label. CMU, if ambitiously executed, can eventually deliver tangible benefits to EU citizens in terms of more jobs, growth, and a more stable financial system. The challenge will be to keep the momentum going despite the structural nature of the effort and the technical nature of the project, which makes it difficult to explain to broader audiences. Encouragingly, the new EU consensus, which recognizes the need for stronger capital markets as a way to make the financial system both more efficient and more resilient, is supportive. However, the political and technical obstacles are also significant.

Many of the policy proposals in the previous section imply institutional changes. They envisage an expansion of the authority granted to both ESMA and the ESRB, and the creation of new EU-level bodies, which may be needed to ensure adequate independence and/or specialized expertise (eg for the oversight of audit firms).

There have been several expressions of concern in early debates about the CMU, particularly but not exclusively in the UK, concerning the risk that proposals for institutional change might work against achieving the aims of the CMU. For example, the UK House of Lords argued that 'any attempt to establish a system of pan-EU supervision would not only be contentious, but could prove an unhelpful distraction from the necessary reforms that Capital Markets Union is seeking to bring about'.⁴⁶ However, this argument misleadingly paints the institutional question as black-and-white, and ignores the fact that ESMA is already mandated to supervise credit rating agencies and trade repositories on a pan-EU basis. In reality, the institutional question is of a practical, not ideological nature. Some aims of the CMU can be attained without changes in the respective institutions' mandates, and some cannot. This is best determined on a case-by-case basis. Both the present and the future situations are and will be hybrids between two extremes, in which supervision is, respectively, all-national (an unnecessary step backwards from the status quo) or all-European (an unrealistic and unnecessary prospect that would sit oddly with the subsidiarity principle).

A more helpful distinction is between prudential supervision, which is typically coupled with a resolution framework with possible fiscal implications, and other aspects of financial supervision such as authorizations of funds and of securities issuances, and enforcement of capital markets rules. In the current phase of EU integration, the former could be pooled within the banking-union area, but pooling across the entire EU appears more problematic, given potential fiscal implications for which taxpayers are the final backstop. By contrast, EU-level pooling of authority over the regulation of financial conduct would not 'impinge in any way on the fiscal

46 House of Lords (n 6) para 75.

responsibilities of member states' (to quote from the legislation that created ESMA and the other ESAs). The logic that led EU Member States, including the UK, to support the creation of ESMA has not changed, and an adjustment of ESMA authority should not be considered intrinsically contentious if it can help to address certain issues better than the current division of labour among national authorities.

The current setup of ESMA and other EU-level agencies should not be considered untouchable. On the contrary, it needs change. The funding mechanism envisaged for the ESAs has not functioned effectively,⁴⁷ and their governance has proved less than optimal in terms of the effectiveness, independence and quality of the decision-making process.⁴⁸ The reform of the ESAs' governance and funding, which is specifically expressed as part of the mandate given to the commissioner for financial services by the Commission's President,⁴⁹ should thus be closely coordinated with the development of the CMU project. In the case of ESMA, the increased concentration of capital markets activity (though not of the economic benefits of strong capital markets) in a limited subset of Member States raises particular questions about a framework in which each Member State is currently represented on the ESMA supervisory board by its national securities regulator.

As mentioned in the previous section, the prudential oversight of CCPs is a special case. The recent reforms of derivatives markets have increased the systemic importance of CCPs, and their implementation is still far from complete. The reform agenda itself, as defined at the global level during the September 2009 G20 Pittsburgh Summit, has not taken into account cross-border interdependencies in a fully adequate manner. Thus, the challenges posed by CCPs with significant international activity, such as those affiliated with the London Stock Exchange and ICE groups in the UK, raise both global and intra-EU coordination questions. It would be advisable for the EU to find answers to such questions to be delivered at the global level, difficult as that may be, before it envisages their permanent settlement in a consistent manner inside the EU. In this respect, the best way to avoid politically challenging debates about supranational supervision, be it at EU or global level, would be to devise and adopt strictly rules-based resolution mechanisms which give no discretion to authorities, and distribute losses automatically among market participants in the unlikely event of a systemic failure. While such rules-based mechanisms cannot be entirely practical for banks, they might be better suited to the distinguishing features of international CCPs.

So far, the European Commission has shied away from any attempts at institutional reform. Concerns about negative interferences with the campaign for the UK referendum on EU membership may have played a role in its caution. It is conceivable and desirable, however, that the EU shows more initiative in this area after the referendum (and assuming the UK stays in the EU), as signalled in the 'Five

⁴⁷ See eg the joint letter sent by the Chairs of the three ESAs to the ECOFIN president on 5 November 2014 <https://eiopa.europa.eu/Publications/Other%20Documents/ESAs_2014-41__Joint_ESAs_letter_to_EU_Council_Presidency_-_ESAs_Budget_2015_.pdf> accessed 24 April 2015.

⁴⁸ The most striking example has arguably been the ill-starred stress testing of EU banks coordinated by the European Banking Authority (EBA) in 2011, which was marred by governance shortcomings in spite of the best efforts of a competent EBA leadership and staff.

⁴⁹ Juncker (n 3).

Presidents' Report' of June 2015 which hints in general terms at future integration of the EU's financial supervision architecture.⁵⁰ The area of accounting and auditing may be judged particularly promising in this respect, especially the two main proposals outlined in the previous section on IFRS enforcement and audit regulation and oversight. The need for high-quality comparable information across the EU can hardly be disputed as a precondition for the success of the CMU. Financial practitioners recognize that the current policy framework does not achieve this aim. The EU can capitalize on the successful adoption of IFRS a decade ago to claim legitimacy in this area. Furthermore, reform is made more urgent by the need for cross-border accounting and auditing consistency in the euro area to support the operation of the banking union. Early commitments would also be desirable on other proposals made in the previous section, such as on system-wide monitoring, listing authority, fund approval and enforcement.

To tackle the most complex areas, the EU could build on its general announcements of September 2015 and create parallel processes of analysis and development of policy proposals in the following five areas: corporate credit information; financial infrastructure; insolvency and debt restructuring; financial investment taxation; and the retrospective review of the aggregate impact of capital markets regulation passed in the last decade, in the wake of the ongoing public consultation. Given the complex and technical nature of these topics, and also the fact that they span the remits of several commissioners and directorates-general within the Commission, it would be advisable to entrust autonomous task forces with the analysis and the development of corresponding policy proposals. Their specific design and governance might vary for different issues and should take into consideration past processes that were judged successful.⁵¹ The Commission should set target dates for these task forces to deliver detailed proposals, say in the course of 2017, so that subsequent legislative implementation could be well underway by the time the current EU legislative term ends in mid-2019.

Last but not least, the economic impact of the CMU on the EU depends in part on its international openness. As the commissioner for financial services put it, 'the CMU is not about closing doors to the outside world. On the contrary, we want to see more investment from outside investors'.⁵² This implies that, as an indispensable complement to its CMU agenda, the EU should champion international financial regulatory standards and other global initiatives as it has done in the past—not least its landmark adoption of IFRS a decade ago. The EU should look critically at past episodes, for example, related to the design and implementation of the Alternative Investment Fund Managers Directive or the European Market Infrastructure Regulation, which triggered debates about discrimination against non-EU service

⁵⁰ Jean-Claude Juncker, 'Completing Europe's Economic and Monetary Union' (2015) <https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf> accessed 2 March 2016.

⁵¹ Examples of successful task forces include, at the EU level, the Giovannini Group and the Larosière report, both of which were supported directly by the European Commission; and in individual Member States, the Independent Commission on Banking in the UK, which was supported by an autonomous temporary secretariat composed of officials seconded from several government departments and agencies.

⁵² Jonathan Hill, 'The Transatlantic Relationship in Financial Services: a Force for Positive Change', speech at the Brookings Institution in Washington, DC (European Commission, 25 February 2015).

providers. The EU should be exemplary in complying with global standards. It should give its full support to global bodies with agendas and mandates that are aligned with the objectives of the CMU, in particular the FSB, Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO). Far from being driven by idealism, such global commitments would respond to the EU's hard-nosed vested interest in favour of an open and rules-based international financial order.