Next steps for the European Capital Markets Union (CMU)

Contribution by the Dutch Authority for the Financial Markets (AFM) and De Nederlandsche Bank (DNB)

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Introduction: Next steps for the European Capital Markets Union (CMU)

The Capital Markets Union (CMU) is essential for a competitive and resilient Europe, yet progress is sluggish and European capital markets remain fragmented. Deeper and more integrated European capital markets will support economic growth and strengthen financial stability. The EU's financial system remains bank-dominated, leading to concentration of systemic risk due to inherent maturity mismatches, high leverage, and interconnectedness. A well-developed CMU improves the resilience of the European economy by its potential to distribute shocks more evenly across the EU through diversification and more private risk sharing. Furthermore, market-based financing can stimulate equity funding that is more suitable for SMEs or higher-risk innovative projects.

With an increased need for achieving 'open strategic autonomy', completing the CMU has become more important than ever. It has become a priority to ensure that the EU generally, and the CMU specifically, could operate independently from major financial centers outside the EU. Open strategic autonomy can only be achieved with a more positive mindset: what can be done to make the CMU more attractive for investors, to lower the cost of capital for business, and how can we build on the strengths of the CMU? A level playing field between European (domestic) and foreign market participants is paramount.

This paper takes a global view to shape the right policies and create a competitive European capital market. A global view of the CMU puts the EU in a position to interact and compete with other regions, and incentivizes policymakers to look beyond individual Member State designs and interests. By extension, the focus should be on improving the quality of our financial markets. In order to do so, a robust level-playing field with other jurisdictions globally is necessary to prevent liquidity and innovation from moving elsewhere. Where possible, regulatory burden and complexity should be reduced. The focus should be on reducing the cost of compliance without compromising on investor protection, market integrity and stability.

The AFM and DNB call on policymakers to complete ongoing initiatives and take an ambitious approach to build a truly European capital market. We acknowledge the initiatives that have been undertaken by the European Commission under the 2015 and 2020 action plans. Important milestones were reached to improve the availability of relevant and harmonised data on markets and companies through the agreements on the European Single Access Point (ESAP) and the consolidated tape. These will be major advances once operational. Nevertheless, more progress is needed to build a competitive and truly European capital market. In this paper, the AFM and DNB put forward a list of recommendations to address several important issues. These proposals will (1) promote uniformity in supervision, (2) encourage (national) endeavors to expand the size of European capital markets and (5) further reduce information asymmetries through amongst others establishing an EU-wide credit registry. In addition, several other (3,4,6) targeted policies could further enhance the competitiveness and stability of Europe's capital markets.

List of Recommendations

1. **Make targeted changes to ESMA's mandate to reduce regulatory uncertainty and improve supervisory effectiveness**
   - Progressively shift supervision of critical cross-border financial market infrastructures to the central EU level. A step-by-step approach can be used in which capital markets supervision is first coordinated at the European level and then centrally managed.
   - Improve the application of uniform reporting standards and foster centralization of systems and data registers towards ESMA.
2. **Stimulate and support (national) efforts to grow the size of European capital markets, by making investment products work in the best interest of EU citizens**
   - Draft national capital market strategies, with support from the European Commission. Focus areas could include retail participation in equity markets, auto-enrolment pension plans and financial literacy programs.
   - Create clear sustainable product labels under the Sustainable Finance Disclosure Regulation (SFDR) that investors can easily understand: "transition", "sustainable" and "sustainable impact".[1]
   - Reduce the gap between required and available pension income, amongst others by introducing regular financial health checks and reconsidering the role of inducements.
3. **Promote access to and competition in the European capital markets**
   - Evaluate the CCP location policy and EMIR review within the context of the CMU, by focusing on increasing the attractiveness of clearing in the EU compared to third countries and avoiding higher costs and inefficiencies for European market participants.
   - Adjust the IFD/R regime to provide a level playing field for European investment firms compared to their international counterparts.
4. **Further harmonise and improve fundamental single market legislation and enforcement powers**
   - Member States could consider enhanced cooperation procedures for the EU Commission's proposals in the fields of taxation, insolvency or corporate law if unanimous agreements cannot be reached.
   - Strengthen host Member States' conduct supervisors' cross-border competences to mitigate risks to consumer protection stemming from (digital) cross-border business.
5. **Improve the availability and comparability of market and company data within the EU**
   - Establish and maintain central data storage on the central level (EMIR, MiFIR).
   - Pursue an EU-wide credit register as part of the ESAP initiative to eliminate information asymmetries, help lenders manage credit risk and prevent excess indebtedness among borrowers.
6. **Further enhance the resilience of investment and money market funds**
   - Continue the development of a macroprudential framework for investment funds
   - Introduce targeted interventions in the framework for money market funds (MMFs) aimed at reducing liquidity mismatches and adverse feedback loops in times of stress.

1 AFM position paper on improving the SFDR, November 3, 2023
https://www.afm.nl/~/profmedia/files/rapporten/2023/afm-position-paper-on-improving-the-sfdr.pdf

1 Make targeted changes to ESMA's mandate to decrease regulatory uncertainty and improve supervisory effectiveness

The current architecture of conduct supervision in Europe was created in the aftermath of the 2008 financial crisis. The ESAs were established in 2011 and were given more powers in 2017 (ESA Review) and 2020 (CMU action plan). ESMA in particular has been given an increasing number of direct supervisory tasks. The current structure of European supervision does not reflect sufficiently the interconnectedness of European financial markets. In this respect, the CMU is still lagging the European Banking Union which has established a Single Supervisory Mechanism (SSM).

Furthermore, there is increasing pressure on supervisory capacity because of the number of new tasks and growing complexity. This makes it more compelling to establish (new) tasks at the central European level. This is particularly true with regards to the collection and processing of data, given the need for a pan-European supervisory view on related risks. In addition, progressive integration may increase support for ESMA to take on a greater role in the supervision of market participants serving the entire European market from one or only a few jurisdictions.

Centralised supervision at ESMA can help to reduce market fragmentation and contribute to a better functioning and more integrated European capital markets. We suggest progressively shifting more supervision of critical wholesale cross-border financial market infrastructures, such as CCPs, but also trading venues and large asset managers, to the European Union level. For ESMA to enhance its effectiveness, its funding model and governance may also need to be reviewed.

Creating a more effective central markets' authority should be a key priority of the next CMU action plan. While much effort has gone into building a single rulebook, its interpretation and enforcement remains fragmented and burdensome for supervised entities. A centralized approach could help internationally operating firms by enabling them to interact with a single supervisor, reduce the costs of compliance and let market participants rely on a single interpretation of laws. It also avoids the need for building up supervisory capacity in multiple jurisdictions. The best way to achieve this is by following a step-by-step approach in which supervision of capital markets is first coordinated at the European level[2] and then centrally managed (SSM-like). By taking this approach, supervision can benefit from and complement NCAs' expertise, while at the same time addressing concerns related to appropriate budgeting and resources at ESMA. This approach would allow for governance mechanisms with the appropriate checks and balances.

Centralised supervision can help to reduce market fragmentation and contribute to a better functioning and more integrated European capital market. It will boost the CMU as it:

- Counteracts regulatory arbitrage;
- Efficiently and effectively addresses cross-border problems;
- Efficiently pools technical expertise (no need to build up expertise in multiple jurisdictions);
- Provides for a holistic overview of market data;
- Avoids supervisory overlaps across jurisdictions;
- Creates a one-stop shop for market participants;
- Leads to economies of scale especially in IT investments.

In order to empower ESMA, exploit economies of scale and better deal with underlying risk, we suggest to:

- Shift more supervision of critical cross-border financial market infrastructures to the European Union level, where it is meaningful to do so. We believe that, in principle, supervision should be centralized where markets are highly integrated cross-border, where rules are harmonized and where there is a residual risk of supervisory arbitrage. Common supervision better guarantees impartiality and stimulates competition.
- There are several benefits by using an SSM-like approach in the case of centralized supervision. First, such an approach can benefit from national and clustered regional expertise, especially in the short-term where concerns could arise related to appropriate budget and resources at ESMA and concentrating authority without having appropriate checks and balances in place. In this case, lessons can be learned from the ECB/SSM staffing process for their 'Joint Supervisory Teams'. For ESMA to be successful it will be key that it works closely together with NCAs and leverages on their expertise and knowledge. One can consider a model where ESMA and NCAs gradually grow towards a full-fledged single supervisory mechanism.
- One area where this approach can be used is (larger and systemic) European CCPs, given the cross-border and interdependent nature of clearing activities across Europe. In this regard, a shift towards fully centralized European supervision would need to be accompanied by a European CCP resolution regime that does not hold national resolution authorities responsible in case a (larger and systemic) European CCP

2 This is already the case for CCPs, with the establishment of a CCP Supervisory Committee chaired by ESMA in 2020 and the strong role for supervisory colleges in approving supervisory decisions.

enters into resolution as well as a European solution to the issue of fiscal responsibility of Member States. Further down the line we also potentially see advantages in the area of: trading venues and asset management, where the large (international) fund managers could be subject to central European supervision, but small managers (with largely national clients) remain under national supervision. For retail investment firms, we do not see a strong need to centralize supervision in the near future, given that markets are still mainly local.

Finally, ESMA's current funding model is a stumbling block and should be brought into line with international best practices based on a small levy on capital markets activity under the scrutiny of the European Parliament. Despite having very few firms under its supervision, ESMA is required to recover a substantial part of its funding from the supervisory fees it levies. The resulting fees, or supervisory costs experienced by these firms, thus become prohibitive. The regulation for ESG rating agencies is important in this respect, as the costs currently envisaged will make it unattractive for existing large ESG rating agencies to operate in the EU and smaller EU ESG rating agencies will struggle to establish themselves.

2 Stimulate and support (national) efforts to expand European capital markets, by making investment products work in the interest of EU citizens.

European households hold a relatively large share of their financial assets in cash or deposits. By shifting their savings toward financial instruments, EU households could share in the higher returns that can be achieved on capital markets for investors with sufficiently long-term horizons. The composition of households' financial assets varies greatly between Member States, with taxation and old-age schemes playing a pivotal role.

We invite Member States to draft strategies to increase the size of (national) capital markets. The Commission can support these efforts and safeguard their contribution to convergence and growth of European capital markets, for example by providing Member States with country-specific recommendations or a non-binding opinion on the proposed national capital market strategies. The Commission can furthermore take the lead in identifying and promoting best practices and benchmarking national efforts aimed for instance at increasing retail participation and removing barriers to capital market growth. Focus areas could be:

- Ensure that investor advice is independent and in the best interest of the consumer;
- Auto-enrolment pension plans, which can help shift significant amounts of savings towards capital markets, as has been shown in the UK where auto-enrolment was launched in 2012 and private pension participation increased from 42% to 86% in 2021[3];
- Financial literacy programmes that help convey the wealth-generation effect of long-term investments;
- Initiatives to support standardization and comparability of financial products to enhance access and reduce costs for retail investors.

In addition, we propose creating clear sustainable product labels under the Sustainable Finance Disclosure Regulation (SFDR) to align investor expectations and objectives. As a review of the SFDR is ongoing, we propose establishing a legislative framework that supports investors in their sustainable investment decisions. These labels would enable investors to understand the different types of sustainable investment products and how positive impacts can be made. Adequate and clear information on sustainability is essential for the functioning of the sustainable finance market.

Finally, the issues of underdeveloped capital markets and pension adequacy should be treated in a holistic manner. At EU level, various CMU initiatives have rightly been taken to improve pension adequacy. In 2021 EIOPA provided excellent advice on pension dashboards and tracking services, which increase the information position of policymakers and individual citizens about pension adequacy. The European Commission has published a study about best practices in auto-enrolment in pension schemes. The Retail Investment Package aims to increase accessibility and attractiveness of Europe's capital markets for ordinary investors. The PEPP regulation has been

3 UK Department for Work and Pensions, 2022

passed several years ago. All these initiatives are welcome, but insufficient to tackle the underlying challenges. Ageing populations and decreasing expected returns across Europe are creating a gap between required and available pension income. State social security systems become strained and occupational and private pensions are not always sufficient. Current estimates show that about one in five EU citizens run the risk of old-age poverty.[4] Better information does not necessarily lead to better behaviour. Good products do not always attract customers: the take-up of the PEPP has been very limited so far.

From a CMU perspective, the pension gap can be narrowed through initiatives on both the supply and demand side. The supply side covers the accessibility of retirement and other relevant financial products**.** Do they offer value for money and do they meet citizens' needs? Supervisors and policy makers need to keep working at solutions for pressing problems with financial products: the financial industry has successfully lobbied against the European Commission's efforts to tackle the harmful effects of inducements. That has not made inducements any less harmful. Generally, many products that are being used for retirement purposes are too expensive, hollowing out long-term returns for ordinary people and failing to fulfil one of the capital markets' core tasks vis-à-vis citizens. Providing a secure and adequate retirement income for ordinary citizens is a key function of financial markets. In order to get there, the EU should reflect on inducements and consider strengthening and enforcing value for money requirements in product governance regulations.

On the demand side, there is a need to raise awareness of potentially insufficient pension savings, as well as related behaviour including inertia, bias, and loss aversion. Retirement planning, savings, and pensions are often neglected until it is too late. Worse, citizens might not even be aware of the (in)adequacy of their pension. They may benefit from regular 'financial health' checks or tailored advice when major changes occur in their lives. There is a role for financial advisors, supervisors, and financial literacy initiatives in creating awareness. Transparency and information on consumer behaviour could assist in understanding and accessing capital markets. A positive contribution towards resolving these issue can be identified in the EIOPA's recommendation to the European Commission on introducing requirements in relation to institutions for occupational retirement provision (IORPs).

4 https://www.eiopa.europa.eu/system/files/2023-09/EIOPA-BoS-23-341-Advice_IORPII_review.pdf

3 Promote access to and competition in the European capital markets

Promoting access to and competition in the European capital markets should be done by increasing the attractiveness of the CMU with a focus on pull factors instead of push factors.

First of all, to achieve open strategic autonomy in the context of the European clearing landscape, the CCP location policy (EMIR review) deserves attention. Unnecessary splits in liquidity pools, inefficiencies, and higher costs should be prevented. A focus on pull factors may reduce unintended consequences from a financial stability perspective, as opposed to mandatory measures which could lead to adverse shifts in liquidity to third countries.

Secondly, we see a need to adjust the IFD/R regime to provide a level playing field for European investment firms (operating under IFR and IFD) compared to their international counterparts. The IFD/R regime, which covers several of the key-players in the CMU, was created with the right intentions: to have a proportionate prudential framework for investment firms to match their specific activities, risks, and business model. However, the regime is not perfect and requires some adjustments, for example in the classification regime, governance and remuneration requirements, and proportionality generally. As it stands, certain aspects of the regime could have a negative impact on competitiveness of EU firms relative to non-EU firms, and hence on the attractiveness of the CMU and the ability of EU investment firms to enable and service the CMU.

4 Further harmonize and improve fundamental single market legislation and enforcement powers

Meaningful harmonization of corporate insolvency laws is necessary to facilitate cross border capital flows by reducing uncertainty and risk in executing these transactions. There is broad consensus that the EU needs to further harmonize key underlying 'fundamentals' such as tax, insolvency and corporate law to truly build a single capital market.[5] The first CMU action plan have not led to a breakthrough in stimulating and facilitating cross-border capital flows.[6] A well-functioning and harmonized insolvency regime improves the allocation of scarce resources in the economy and thereby supports economic activity.

We welcome the EU Commission's proposals on withholding tax and insolvency proceedings as well as the initiatives to harmonize the definition of shareholder, voting rights and corporate action processing rules as part of the review of the Shareholder Rights Directive II. Since it has proven difficult to reach political consensus on these issues, we suggest that Member States consider using the enhanced cooperation procedure to make progress in key areas for the CMU. While clearly a second-best option, cooperation among a subset of willing Member States is better than none at all.

In addition, it is important that consumers are sufficiently protected to ensure further consumer engagement on European capital markets. Therefore, in line with a joint Dutch AFM-French AMF position paper[7], we further propose strengthening the cross-border competences of host Member States' conduct supervisors in order to mitigate risks to consumer protection stemming from (digital) cross-border business. While centralized European supervision of cross-border business might be preferable, it will take many years to construct. To protect consumers from harmful cross-border practices, host NCAs' competences should be increased in the short term. Better consumer protection can incentivize consumers to enter into cross-border services or buy financial products in other member states.

5 https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2019/09/06/A-Capital-Market-Union-For-Europe-46856
6 https://www.eca.europa.eu/Lists/ECADocuments/SR20_25/SR_CMU_EN.pdf
7 https://www.amf-france.org/en/news-publications/amfs-eu-positions/french-and-dutch-financial-market-authorities-call-stronger-conduct-supervision-framework-national

5 Improve the availability and comparability of market and company data

Centralizing capital markets data in Europe offers numerous advantages, enhancing regulatory effectiveness and fostering cross-border cooperation. It allows for a more comprehensive understanding of risks, facilitating timely responses to emerging challenges (such as cross-market manipulation). For financial institutions, the advantage is that they only need to provide data in one place.

With political agreements on the ESAP project and the consolidated tape reached last year, significant improvements in the availability and comparability of market and company data are now in the pipeline. We see potential for an EU-wide credit registry to enhance ESAP's ability to bring borrowers and lenders together across the EU. And as cross-border information flows improve for private actors, the need for centralization of supervisory data intensifies – for both monitoring and operational efficiency purposes.

A more integrated European capital market would benefit from data centralization. There are multiple advantages to centralization of data. First, supervisory objectives can be better achieved with an integral data set as opposed to subsets of available data. A more comprehensive overview of the EU financial markets would improve the supervision of markets manipulation by enabling quick detection of suspicious cross-border activities and facilitating real-time monitoring. Second, centralized data collection itself is more efficient because national data infrastructures will be unloaded from a considerable amount of data. In addition, this will be further boosted by the natural and consequent optimization of data exchange between NCAs.. Furthermore, supervised entities only have to deliver their data once to a central hub instead of to multiple NCAs. This should lower the overall costs of data collection, processing, and interpretation, as there is centralization of storage compared to 27 NCAs operating with their own IT infrastructure. We would opt for a step-by-step approach by making a clear distinction between the collection, processing, storage, quality assurance and analysis of data.

Another area for centralization would be the sustainability data reported under the SFDR and CSRD. An important distinction between the SFDR and other Regulations or Directives, for example with regard to transaction data, is that sustainability disclosures based on the SFDR in general do not have to be reported to NCAs. Supervised entities must disclose certain data and other sustainability information to their clients. Of course, if multiple European NCAs are going to develop a supervisory approach that includes collecting this data, it might be worthwhile developing something jointly. Besides, consumers, rating agencies and other kinds of financial intermediaries would benefit greatly from having a single access point for this kind of information. Comparison will be easier and more efficient, and competition can lead to better performance and clearer disclosure. The data based on the CSRD does have to be reported to NCAs. The challenge here is the lack of standardization. It would then be possible to develop a central capability to

collect the data in the future, but the first stage should be clear standardization and centralization of the requirements.

Pursuing an EU-wide credit registry as part of the ESAP initiative can help eliminate cross-border information asymmetries in lending markets, particularly in the SME segment. The lack of comparable and reliable credit information are often cited hurdles to cross-border (market) financing of SMEs. A European credit registry addresses such hurdles head-on, increasing competition in credit markets and could decrease borrowings costs for SMEs. As an additional benefit, fragmentation in lending conditions across Member States may decline. An EU-wide credit registry would also inform potential lenders in their assessment of the overall indebtedness of would-be borrowers, thereby improving credit management risk. Some EU countries, such as Belgium, Portugal, Italy and Spain, already have national credit registries that help lenders and borrowers find each other by bridging information gaps. At the EU level, the Anacredit database may provide the starting point for building a credit registry. A pan-European registry would naturally fit the ESAP initiative and could be implemented as an additional stage through the inclusion of more data. As a first step the Commission could undertake an impact assessment to see whether the benefits would outweigh the cost in setting up such credit registry.

6 Further enhance the resilience of investment and money market funds

The significant growth in non-banking financial institutions (NBFI) underlines the sector's importance from a financial stability perspective. Recent episodes, including the March 2020 market turmoil, the Archegos collapse, the Liability-Driven Investment (LDI) Fund crisis in the UK and the stress in commodity markets early 2021, illustrate the potential of investment funds and other NBFIs to generate systemic risk by amplifying and transmitting market shocks. While work to address such systemic risk is ongoing at an international level, further steps are required to develop a comprehensive macroprudential framework at the European level.

Non-bank financial intermediaries play a pivotal role in funding EU businesses, which is essential for the advancement of deeper and more integrated European capital markets. As the presence and influence of investment funds within the financial system grows, we believe that it is important to take continued steps towards addressing their structural vulnerabilities. We support the current initiatives aimed at mitigating the risks associated with investment funds and advocate for the development of a comprehensive macroprudential framework within the European context. To this end, we believe it is essential to adopt a balanced and phased approach, initially focusing on repurposing existing tools by embedding the macroprudential perspective into current regulations This also applies to regulatory initiatives already underway, such as work on RTS's and Guidelines. This will go a long way in enhancing the overall resilience of the investment fund sector in the face of shocks. In further developing this macroprudential perspective, we consider addressing data gaps and developing (harmonized) analytical tools to be key prerequisites.

More specifically, targeted interventions are needed in the macroprudential framework for money market funds (MMFs). Money market funds perform a crucial role in the short-term funding of financial institutions and corporations. The need to reduce the likelihood of adverse feedback loops and amplification effects through MMFs in times of stress was illustrated by the significant liquidity stress faced by these funds during the COVID-19 crisis (i.e. dash-for-cash). While we positively view the recent work that has been done in light of the AIFMD/UCITS review, including on liquidity management, there are remaining shortcomings and structural issues that warrant dedicated regulatory adjustments to increase the resilience of money market funds. In this regard, it is important to note that the specifications of liquidity management and potential threshold effects of liquidity management tools (LMTs), are to some extent specific to MMFs. This is for instance the case when it comes to the coupling of the potential activation of liquidity management tools to liquidity thresholds. In addition, macroprudential policy should work to reduce liquidity mismatches at MMFs. In this context, further consideration may be given to proposals that adjust liquidity requirements and aim to have liquidity requirements act countercyclically. This could for example be realized by accompanying such liquidity requirements with the possibility of holding public debt assets to meet daily and weekly liquidity ratios.

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