Single Market

CAPITAL MARKETS UNION: STATE OF PLAY AND WHAT LIES AHEAD

Four years since the European Commission adopted the action plan on the Capital Markets Union (CMU), a lot has been done to further integrate and deepen the EU’s capital markets. While there has been real progress in facilitating cross border investments and innovative financing, there are still many challenges lying ahead – something the new Commission is committed to tackling head on.

In Europe the need for substantial investments in infrastructure, new technologies and the successful transition to a greener economy is enormous. According to the European Investment Bank’s 2016 estimates, the EU’s economic infrastructure investment needs could be as much as €688 billion per year until 2020, while additional estimates for social infrastructure suggest that the investment gap for health, education and social housing is around €142 billion per year. According to the Commission’s 2018 strategic plan for a climate-neutral economy, around €520-575 billion of investment is needed to achieve net-zero greenhouse gas emissions by 2050. A well-functioning CMU can help meet those needs. The CMU is primarily about allowing capital to flow more easily across the EU to where it is most needed. It is about ensuring that accumulated savings get put to good use in productive investments thus supporting future growth.

According to the 2015 Action Plan on CMU, if the EU’s capital markets were as deep as those in the U.S., more than EUR 90 billion of funds would have been available to finance companies between 2009 and 2014. This could have made a real difference in allowing the EU to bounce back much more quickly than it did from the economic crisis.

Deeper, more liquid and integrated markets are essential to ensure the EU can grow, be more productive and competitive. They are very important for fast-growing SMEs and start-ups that are the largest source of employment in the EU. Those companies can find it hard to access funding they need in order to expand.

That is why breaking down barriers that stop capital from flowing easily across borders is one of the key objectives of the CMU. It calls for important and deep structural reforms, such as changing market participants’ well-established market practices and removing barriers stemming from national laws.

TARGETED ACTIONS

Thanks to a set of targeted actions, the CMU seeks to develop a more diversified financial system in the EU complementing bank financing, facilitating capital raising through alternative channels, such as crowdfunding, venture capital and public markets.


2. Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank – A Clean Planet for all A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy, COM/2018/773 final, 28 nov. 2018.
Since its inception, the CMU has been built around six core objectives:
1. Develop new sources of financing for companies that are not quoted on public stock exchanges;
2. Facilitate the entry of companies on the stock markets and to allow them to raise capital more easily;
3. Promote investment in infrastructure and green finance;
4. Stimulate the investment of institutional and retail investors;
5. Help banks finance the European economy;
6. Break down unjustified barriers to cross-border investment in the EU.

ACHIEVEMENTS SO FAR
We have made significant progress since launching the Capital Markets Union in 2015: the European Commission tabled all of the 13 concrete legislative proposals it had committed to as part of the CMU Action Plan and Mid-term Review, and eleven of those have now been agreed. The Commission has also moved forward with almost all of the non-legislative measures it had announced. The adopted proposals include measures to promote more accessible and diversified funding for companies at all their stages of development, measures to increase the transparency and integrity of capital markets, and to remove cross-border barriers to capital flows. Together, these reforms make it safer, more transparent and more attractive for investors to provide funding at home and on a cross-border basis. As such, they contribute to allocating capital more efficiently by channeling funding where it is most needed, notably to innovative companies and long-term projects. Last but not least, the adopted measures contribute to making the European financial system more resilient in case of a future crisis.

For example, the creation of an EU Growth Prospectus and the rules adopted for SME Growth Markets make it simpler and cheaper for SMEs to access public markets. SMEs – referred to by Vice-President Valdis Dombrovskis as the backbone of Europe’s economy and job creation – often find it difficult to access the finance they need, which prevents them from unlocking their full potential. According to the Commission’s 2015 Green Paper on Building a Capital Markets Union, banks reject around 13% of the loan applications filed by European SMEs because their credit risk does not meet the banks’ desired risk profile. If we do not foster the development of capital markets, small companies that cannot rely on bank lending will not be able to finance their activity, resulting in significant missed opportunities in terms of growth, innovation and job creation. The new rules on SME growth markets, on the accessibility of venture capital funding through EuVECA funds, or the proposal on crowdfunding, all aim at offering alternative funding possibilities to these companies. Although it is too early to see on the ground the cumulative effect of agreed measures, as only a few are already applicable today, the Commission has delivered on its commitments. The key building blocks are now in place, and the market has reacted positively, as proven by the continuous development of capital markets in Europe since the launch of the project.

CMU IS ALSO AN OPPORTUNITY FOR THE BANKING SECTOR
While one of the aims of the CMU is to reduce companies’ strong reliance on bank financing, banks will remain a major source of finance in Europe due to their established relationships with local market players. They play a crucial role both in channelling citizens’ savings towards adequate financial market products and in orienting small companies to capital markets when lending does not seem appropriate.
The Commission also worked with banks directly to improve the feedback given by banks declining SME credit applications. The European Banking Federation has now developed a Code of conduct on credit feedback which was published on 6 June 2017. All these measures enable banks to play an important role in capital markets supporting EU businesses at various stages of development.

WHAT LIES AHEAD
As the Vice-President said during his September European Parliament hearing, the Commission has successfully laid the foundations of the CMU. However, despite the Commission’s determination, it has not been possible to break down some of the biggest structural barriers that stop the Capital Markets Union from working as it should. These include the divergent insolvency regimes across the EU. The duration of insolvency proceedings in the EU ranges from a few months to several years. This forces investors to take into account the impact of divergent (in length and process) insolvency proceedings when making an investment decision. This entails extra costs and impedes cross-border investment. Burdensome cross-border taxation procedures are another barrier that investors often mention. These deep-rooted and complex issues will require a comprehensive approach and a high level of commitment and ambition from Member States if we are to find solutions. Member States still need to agree on how to break down these barriers. As the Vice-President said, it will be a priority for the new Commission to give a new impetus to the project of completing the CMU. But this cannot be done solely from Brussels. It needs the active involvement, support and follow-up at national and local levels across the EU. To relaunch the CMU, a combination of legislative and non-legislative measures will be needed. These include removing the remaining national barriers to cross-border capital flows, facilitating the engagement of retail investors, and providing further support to SMEs.

AN AMBITIOUS STRATEGY FOR SMES
As VP Dombrovskis also said to the European Parliament, the Commission will continue to prioritise support for small and medium-sized businesses building on measures taken over the last five years to enhance market-based financing for SMEs. One of the ideas would be to set up a dedicated public-private fund that would help SMEs’ access to capital markets. The cost and conditions for SMEs to access the capital markets should also be looked at. These measures will be one aspect of a broader SME strategy that the Commission will put forward as part of its new mandate.

HIGH-LEVEL FORUM
It is time for a “CMU 2.0”. Launched by the European Commission in November, the High-level forum will bring together a group of industry executives, international experts and academics to provide advice to the Commission on what still needs to be done to complete CMU. Group members will have to identify long-term trends that could impact the future of Europe’s capital markets, and determine areas where further action may be needed. In particular, the forum will focus on building a pan-European ecosystem for raising capital for companies (including SMEs), fostering retail investor participation and diversification of the investor base, and strengthening a pan-European financial market architecture. It will report back in spring next year and the Commission will take its recommendations into account before proceeding with next steps to relaunch the CMU.

CONCLUSION
The Single Market for capital is one of the four freedoms of the EU. It is at the heart of more sustainable and innovation-focused economic growth. The Capital Markets Union’s project is about making that single market freedom a reality for all so that businesses and citizens reap its full potential. It has the potential to shape the future of the continent’s economy, to strengthen the resilience and stability of the financial system, and enhance the EU’s attractiveness in the world. You can count on the next Commission to be fully committed to completing the CMU.

The Commission will continue to prioritise support for small and medium-sized businesses.

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