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Detailed CMU Action Plan, but more (ambition) is required

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The concrete outcome of the Commission's Action Plan for a Capital Markets Union (CMU) consists primarily of a few technical proposals. Notably, it calls for the removal of constraints to facilitate SME financing, e.g. through changes to the prospectus Directive. And it also recognises the need to facilitate infrastructure financing and securitisation through changes to the solvency II Directive and the capital requirements Regulation. However useful these proposals may prove to be, they do not address the main problem in Europe's capital markets, which lies on the supply side. Expressed simply, European household savings are not finding their way into more rewarding investments, which is caused by a variety of factors that cannot be easily changed.

With the launch of the CMU by President Jean-Claude Juncker in July 2014, the Commission managed to raise awareness of the importance of well-developed capital markets for economic growth. Following the raft of post-crisis measures, the initiative spurred a new momentum and support within the financial community and across the member states for bold action to create a truly European capital market.

The aim of the Action Plan indeed is to support efforts to overcome underdevelopment and fragmentation of capital markets in Europe. The plan focuses, in its early actions, largely on providing a greater variety of funding opportunities for start-ups and SMEs, infrastructure financing and securitisation. It was accompanied by three immediate legislative proposals for amendments to the prospectus Directive, the capital requirements Regulation, and the solvency II Directive.

Concrete CMU proposals on the table

CMU Action Plan amendments	Purpose
Prospectus Directive	Streamline the information required and the approval process, and create a genuinely proportionate regime
Capital requirements Regulation	Regulatory treatment of infrastructure investments; adapted prudential requirements for simple, transparent and standardised (STS) securitisation products
Solvency II Directive	Regulatory treatment of infrastructure investments and recognition for ELTIFs, adapted prudential requirements for simple, transparent and standardised (STS) securitisation products

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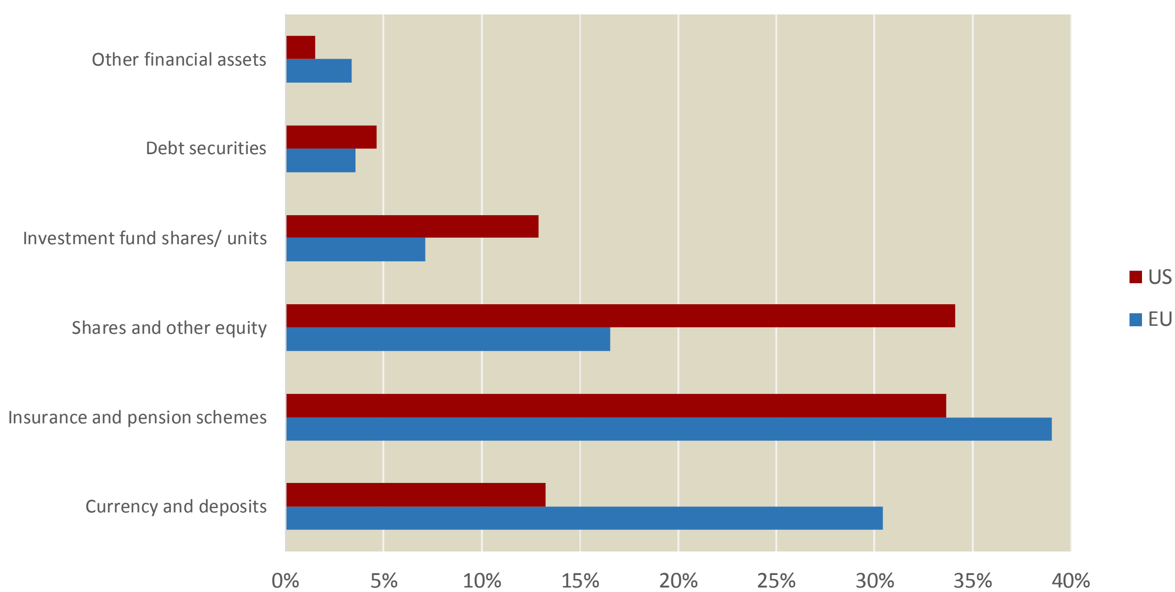
SME[1] financing has been high on the EU agenda for more than a decade. It figured prominently in the discussions on Basel II, with the lower risk weightings for SME loans, and on MiFID I, with the creation of a second tier-market (MTF) and MiFID II, with the SME growth market. The burdens for capital market financing for SMEs have been addressed at national level in several member states, but with mixed success so far. Broader issues are at stake preventing firms from going to the markets. For example, overcoming information barriers to investment in SMEs is crucial. A set of tailored actions to increase the quality of company data across Europe is necessary. Re-launching securitisation markets is also important, but the question remains whether this will create a truly EU-wide product rather than an EU-wide passport for national portfolios, and whether this can be done without tackling national differences in insolvency laws.

On the other items, the Action Plan calls for further study, consultations and later initiatives. It launches two public consultations on the review of the EuVECA and EuSEF Regulations and an EU-wide framework for covered bonds, and issued a "call for evidence" on the cumulative impact of financial legislation. It will publish a report on long-standing national barriers, e.g. tax barriers, to EU-wide market integration and announced a legislative proposal on business insolvency and early restructuring, both by the end of 2016. But a truly far-reaching proposal is not yet in the cards.

The main problem to be tackled is the overexposure of households to deposits, which do not find their way to the markets. As compared to the US, EU households have more than double the amount of their savings in deposits, but half as much in investment funds and shares (see the figure below). To address this imbalance, bold initiatives will be required in order to improve transparency, harmonise marketing regimes, allow for cross-border competition among product manufacturers and open up distribution channels. The Action Plan is very timid at this stage on creating a new sizeable EU-wide savings product, while at the same time strengthening the enforcement of the existing fund regulatory framework. The Commission will 'assess the case' for such product, without further commitments: *"an 'opt in' European Personal Pension product that pension providers could elect to use when offering products across the EU."*

Composition of the financial portfolios of EU and US households (%, end 2014)



Note: This and more in-depth data analysis is included in a forthcoming report of a Group of experts put together by CEPS to issue recommendations on how to create a European market for capital.

Data sources: EU and US annual accounts data released by Eurostat and the US Federal Reserve.

[1] The EU definition of an SME also needs further revision.

On enforcement, the Commission will cooperate with ESMA to step up country peer pressure. The initial experience of the Single Supervisory Mechanism in the Banking Union can be a useful reference.

It is clear that a Capital Markets Union will not be created overnight. There are profound structural differences between EU member states, and even larger differences compared with the great benchmark, the US. To overcome these, and to live up to the expectations that have been raised, bold initiatives will be needed.

This Action Plan has launched the debate with some concrete proposals and many ideas for further work. But it is only a start – more needs to be done.