A NEW IMPETUS FOR CAPITAL MARKETS TO MEET THE FINANCING NEEDS OF THE UNION

Which priorities for EU Capital Markets?

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The Union has aimed to develop more integrated and deeper EU capital markets since the launch of the CMU in 2015. AMAFI has supported[1] this initiative from the outset, stressing its importance for the financing of the EU economy. Although some progress has been made in the nine years since the adoption of the first CMU Action Plan and its revamping three years ago, there is still a need for deeper and more competitive capital markets. These should be capable of contributing to the EU's prosperity by meeting a larger share of its massive financing needs arising from the green transition, the digital revolution, and the ageing of the population. This issue is even more critical given the dramatic change in the geopolitical and economic context, calling for the development of the open strategic autonomy of the EU.

When it comes to financial markets, the priority of the upcoming European Commission should therefore be to actually develop the financial markets of the Union, taking stock of the fact that the harmonisation of legislation that has governed public action since 2015 was an important but insufficient step towards achieving this objective. What is needed is not a new CMU action plan, but rather a fundamental change of approach, as proposed by ECB President Christine Lagarde in her speech to the European Banking Congress in November 2023[2].

The definition of the upcoming European Commission's agenda is a unique opportunity to position the EU in the global race for competitiveness as it may be too late already. AMAFI is willing to contribute to this reflection by proposing what it considers to be key priorities to enable financial markets to play their fair share in the prosperity of the Union.

1 For further details please refer to AMAFI/ECMI study

2 https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp231117~88389f194b.en.html : *"we can turn our approach to CMU on its head, so that it can become a vital tool in financing the ongoing transformations [...] So what we need today is for all parties to rally around this project, recognising that the future prosperity of Europe depends on it. The second key ingredient is for our shared determination to be embodied in a change of approach."*

AMAFI'S PROPOSALS

A change of mindset for the elaboration of EU legislation

Guiding principles of success

When considering any new reform, its impact should be assessed in terms of:

- The growth of capital markets;
- The competitiveness of EU financial institutions, including also relative to their competitors outside the EU;
- The relative performance of the EU markets compared to the US, the UK and Asia.

Complementing the top-down with a bottom-up approach and encouraging interstate initiatives

To promote the growth of EU capital markets, a bottom-up approach will help develop successful national practices that can be shared across Member States with the support of ESMA.

To initiate much-needed structural reforms, initiatives of groups of Member States should be encouraged with the view of eventually attracting others.

Competitiveness by design

An ad-hoc competitiveness test should be part of the impact assessment of any new legislation.

The extraterritorial application of EU rules

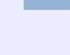
EU investor protection rules should not apply to EU market players when operating outside the Union.

No systematic review of EU texts

Reviews should result from objective impact assessments highlighting proven shortcomings.

Reforming ESMA's mandate and governance

- Adding competitiveness, both within and outside the EU, to the mandate of ESMA
- Reforming the decision making process of the governance bodies of ESMA for a greater impact where needed
- Taking steps towards direct supervision by ESMA

Increasing the agility of the EU legislative process


Broadening the scope of the no action letter that can be issued by the ESAs and ESMA in particular, to come closer to the prerogatives of the SEC in the US.

Two essential reforms to develop the EU financial markets

Enabling financial markets as a deep and stable source of financing for companies

Developing alternative investment vehicles that would transform a sufficient share of EU savings into capital.

Reinvigorating the European securitisation market

Reviewing the regulatory framework applicable to securitisation, including through the creation of a European guarantee scheme

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I. The competitiveness of EU financial markets: where do we stand?

a. A changing world order: financial markets, a strategic sector

The European Union's political, economic and financial relations with the world's major powers and its partners are changing. Russia's aggressiveness at its doorstep, growing tensions between the US and China, the rise of India and the emergence of other rising powers directly challenge the EU's position in a changing world order.

Economically, the EU's ability to remain a major player in key strategic sectors (e.g. defence, telecommunications, transport, pharmaceuticals, digital industry) is at stake, as is its ability to create long-term prosperity for its citizens and not be relegated to a mere consumer market.

Brexit having resulted in the City, once the EU's main financial centre, being outside EU jurisdiction, the Union's capital market is now multipolar, with several relatively small or modest national markets. The development of these markets is hence all the more vital for the financing of the economy and financial stability.

The main financing challenges of the European Union

Massive funding is needed if the EU is to succeed in the race to the digital and green transitions, while meeting the challenge of an ageing population. In its Strategic Foresight Report of July 2023[3], the EC estimated that the green transition would require an additional investment of € 620 billion/year to meet the Green Deal objectives, the digital transition an additional investment of € 125 billion/year and the demographic transition a possible increase of age-related expenditures by 2 percentage points to 26% of GDP by 2070.

These financing needs come against a fairly fragile economic outlook.

A fairly fragile economic outlook for the European Union

Growth in the EU is expected to be around 0.8% in 2023 (1.4% in 2024), inflation is falling but not yet under control (4.9% in the EU in 2023 and 3.2% in 2024)[4] and unemployment although historically low (6.4%)[5], is likely to rise in the short to medium term due to the ECB's historically tight monetary policy.

In this context, it is crucial that Member States and EU companies in strategic sectors and with structuring projects have access to deep and stable pools of financing within the Union and do not become overly dependent on external sources of finance that can quickly dry up in times of acute competitive tensions or crisis.

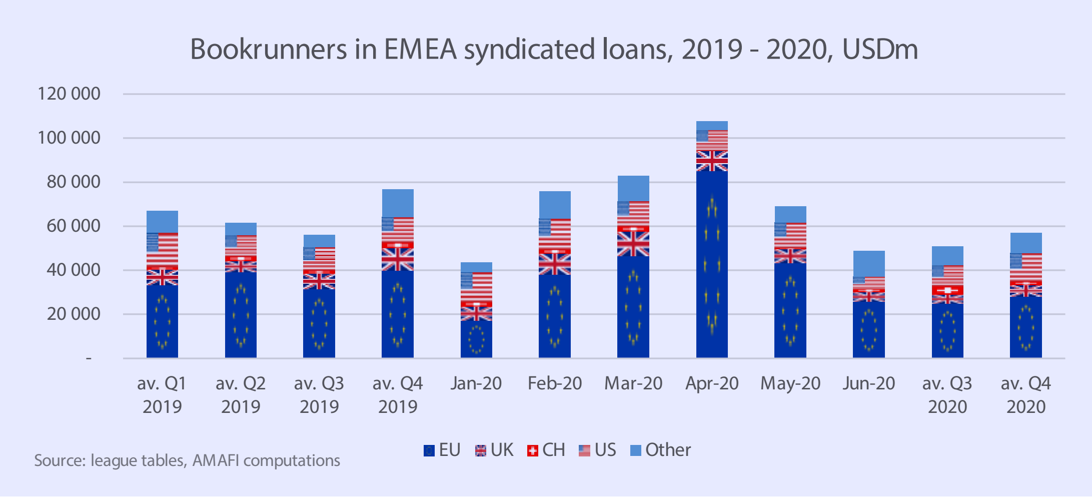
3 European Commission, 2023 Strategic Foresight Report, July 2023

4 https://ec.europa.eu/commission/presscorner/detail/en/ip_23_4408

5 https://www.ecb.europa.eu/pub/projections/html/ecb.projections202309_ecbstaff~4eb3c5960e.en.html

The home bias effect in times of crisis – example of the Covid pandemic

In times of crisis, both investors and financial firms tend to concentrate their resources on their domestic market. This effect was particularly visible in April 2020, at the peak of the Covid crisis: confronted with unprecedented uncertainties, non-European banks rapidly and significantly reduced their participation in the EMEA syndicated loan markets, precisely at a time when needs surged.

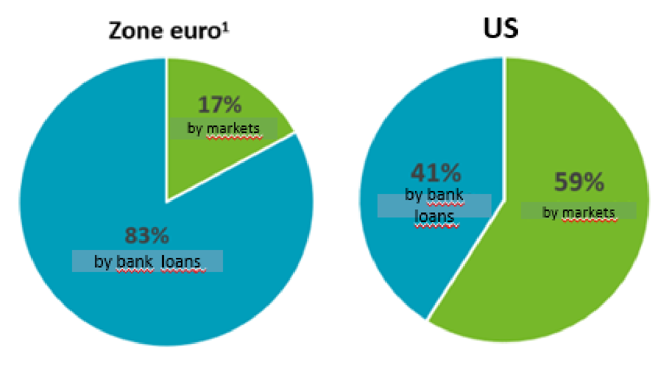


Source: league tables, AMAFI computations

The overarching objective of the upcoming EC should therefore be to continue and accelerate the development of the Union's *Open Strategic Autonomy* in key strategic sectors, in particular financial markets, as they are central in financing the growth of the others.

b. Enabling financial markets to become a more important source of funding

Bank loans remain predominant in the financing of the EU economy, which is at a startling contrast with the US, as illustrated below.



Source: Banque de France, Eurostat, FED

From this perspective, CMU cannot be considered as a success so far, as the share of financial markets in financing the economy has remained limited since the launch of the first Action plan in 2015[6].

6 Christine Lagarde, Speech, European Banking Congress, 17 November 2023: https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp231117~88389f194b.en.html: "*Despite two European Commission action plans, Europe's capital market remains fragmented. Financial integration is lower than before the financial crisis. Bond markets are three times smaller than in the United States. And EU venture capital lags significantly behind the United States, at just one-fifth of the size*".

The political impetus given by the Eurogroup in March 2023[7], which called for stepping up efforts to take the CMU forward, was most welcomed and so was the recent Franco-German political statement on CMU published in September 2023[8]. However, similar declarations from Member States have so far not resulted in real breakthrough, be it typically on the review of the ESAs (European Supervisory Authorities) or on the revitalisation of the European securitisation market (*see below II.2.b. Reinvigorating the European securitisation market*).

At present, financial markets are an underused tool to support the development and transformation of the EU economy, which means that the EU is currently largely deprived of an important source of financing. This underdevelopment is particularly worrying at a time when the EU's financing needs are huge and cannot be met solely by bank lending. **It is now an absolute necessity for Member States and the European Commission to give the markets the means to help meet the financing challenges facing the Union.**

The weakness of Europe's financial markets

"The US stock market is more than twice the size of the European markets in market value ($38 trillion vs $17 trillion) and it is more than twice as deep relative to GDP (165% vs 79%).

Europe and the EU's share of global stock market and IPO activity is significantly lower than their share of GDP. Stock markets in the EU are less than half as deep as in markets like Canada, Japan and the US relative to GDP, and European IPO activity is significantly less developed than global peers.

The number of listed companies in Europe has fallen by 17% in the past decade (a loss of nearly 1,300 companies), while in US the number of companies has increased slightly."[9]

This trend should be seen in the light of the ageing of European listed companies, compared to their US peers.

As an example, in France, *"the average age of the CAC 40 companies is over 100 years. This is an indication of the quality, the level of technological investment and the resilience of our large corporations. However, only one "young" [less than 40 years old] technology company – Dassault Systèmes – has joined the elite ranks of French capitalism. By contrast, the technology sector represents around 30% of the S&P 500's market capitalisation in the United States due to Google, Apple, Facebook, Amazon and Microsoft. These companies are less than 40 years old."*[10] .

At the EU level, Eurostoxx50 companies have an average age of close to 120 years, while their US peers are less than 60 years old on average. Only five of the top EU companies are less than 50 years old, compared to 31 of their US peers, a figure that includes all six of the largest US market capitalisations.

The market cap of European companies, which have been largely absent from the digital revolution, is also significantly lower than that of their US counterparts: the top 50 Eurozone companies have an average market cap of EUR 85bn, less than one fourth of their US peers (USD 400bn).[11]

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7 https://www.consilium.europa.eu/media/63306/2023-03-24-eurosummit-statement-en.pdf

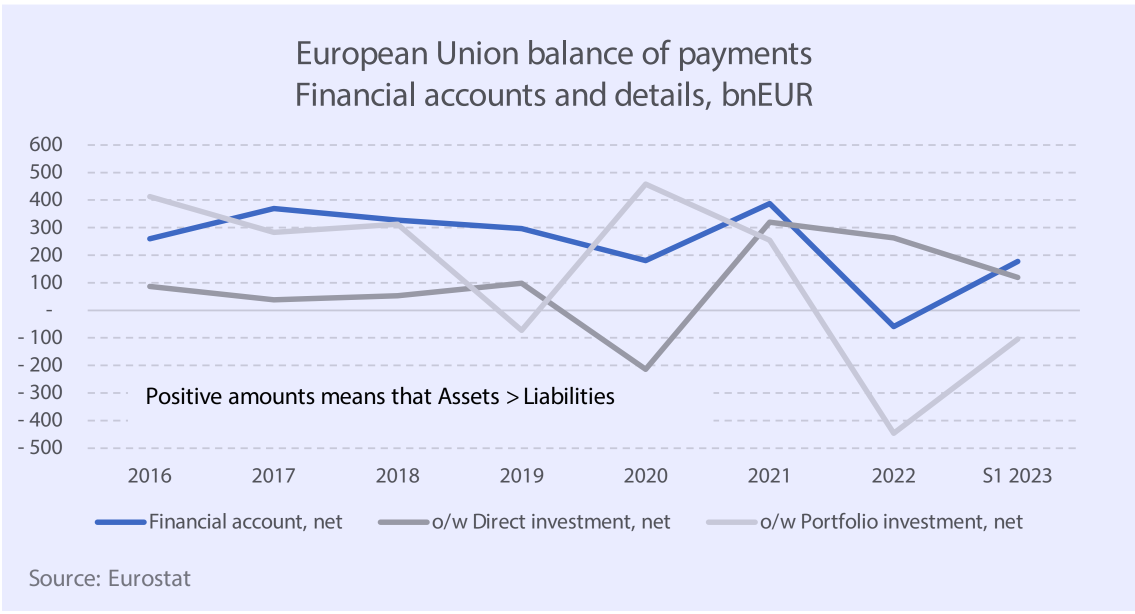
8 FR: https://presse.economie.gouv.fr/13092023-une-feuille-de-route-franco-allemande-pour-lunion-des-marches-des-capitaux/
EN: https://www.bundeSfinanzministerium.de/Content/EN/Downloads/Europe/roadmap-capital-markets-union.pdf?__blob=publicationFile&v=3

9 The problem with European stock markets, NewFinancial, March 2021

10 Philippe Tibi's report "Financing the fourth industrial revolution – Solving the financing grid-lock for technology companies"

11 Figures computed by AMAFI and corrected from mergers and acquisitions.

In this context of massive financing needs, the underdevelopment of EU financial markets is even more frustrating given that a large proportion of the EU savings are invested outside the Union. As shown below, the EU is a net investor to the rest of the world. To put it simply, EU households' savings provide capital to non-EU companies.



Source: Eurostat

It is high time for the Union to establish the necessary infrastructure to convert the savings of its citizens into capital for its companies. This will undoubtedly contribute to the Union's overall prosperity.

c. Fostering competitive EU capital markets

The first CMU Action Plan[12] (2015) contained 33 legislative and non-legislative measures and the second[13] (2020) had 16. Another broad action plan rolled out via multiple pieces of legislation[14] would probably deliver only marginal value. On the contrary, it is critical to build a clear vision and focus on delivering it through ambitious and targeted reforms, with the aim of enabling the Union to meet its financing needs with a degree of strategic autonomy.

To meet those needs, it is critical to foster the attractiveness of EU financial markets and the competitiveness of EU market participants, from both an internal and a global perspective.

From an internal perspective

Strong competition within the EU is indeed essential to ensure that services offered to EU companies and investors, including households, meet their needs at a reasonable price. This competition should thrive from the confrontation of actors originating from the EU itself and third countries, with the latter operating in the EU markets under the same rules and the former able to offer competitive services and prices. Local financial institutions must be able to build profitable business models[15] based on a solid domestic foundation allowing them to make the necessary investments to meet their clients' expectations and sustain their future growth. However, EU financial services actors have lost market share to non-EU competitors since the global financial crisis and their financials are not as attractive.

From a global perspective

The competitiveness of EU financial markets vis-à-vis third country markets is key to continue to address the needs of its companies and investors, at the risk otherwise that they are met elsewhere and do not benefit fully the EU economy. The consideration of the global ranking of the EU financial markets should hence inform the future EU policies.

12 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0468

13 https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan_en

14 The initial objective at the heart of a new piece of legislation tends to dissolve into other topical considerations and conflicting opinions that arise during its drafting, leading to a suboptimal consensus or sometimes even opposite results.

15 Ursula Van der Leyen's Speech on the State of the Union, 13 September 2023: "*Europe is open for competition. Not for a race to the bottom.*"

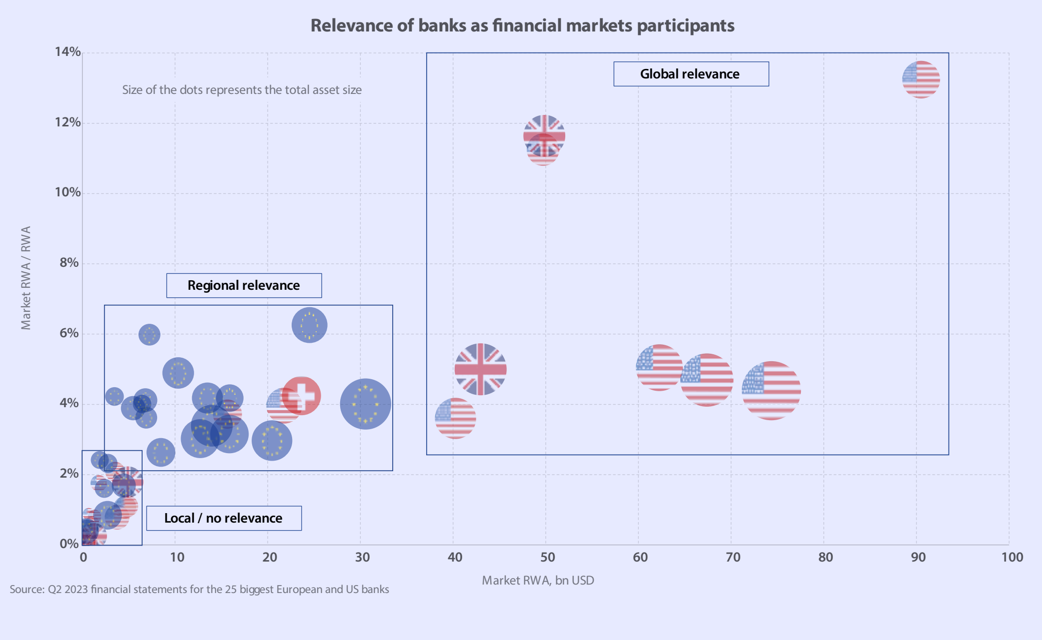
A stock-taking exercise: EU financial markets seen from the sell-side

1) A fragmented EU universe in wholesale capital markets

The dispersion of EU sell-side firms in wholesale markets compared to their US competitors is one factor contributing to the relative weakness of the EU financial markets.

Unlike its US and UK peers, the EU industry of wholesale market and investment banking has not undergone significant consolidation for structural reasons. The homogeneity of legal, tax and regulatory domestic markets, the application of the Glass-Steagall legislation in the US from 1932 to 1999 and the exits / mergers in the aftermath of the financial crisis have clearly contributed to the concentration of the US and UK sell-side industries. In contrast, the differences in tax and legal regimes, as well as the stringent capital requirements imposed on firms by the relevant Member States act as obvious barriers to cross-border mergers in the EU.

This is particularly evident when looking at the size of the market activities of European and US banks. The chart below shows the risk-weighted assets (RWAs) attributed to market risk for the 25 largest European and US banks. This is shown in both absolute terms (amounts in USD billions) and in relative terms (market RWAs as a percentage of total RWAs)[16]. It appears that while 6 US banks and 2 UK banks have global market activities, 15 EU banks compete and struggle to preserve their regional footprint, with only one EU bank having the potential to join the global players. This level of fragmentation clearly limits the profitability and relevance of EU banks in wholesale markets.

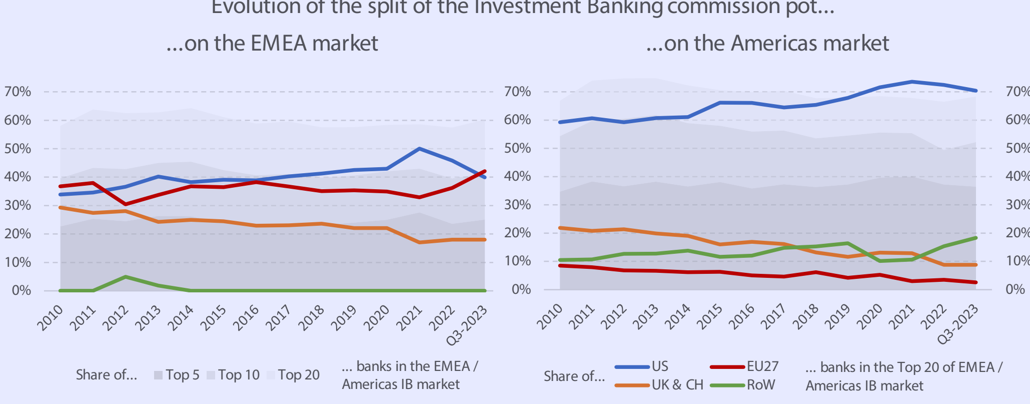


16 Absent homogeneous reporting of revenues derived from market activities, the market-RWA is the best proxy for the size of market activities, as only market activities generate such RWA.

2) *Investment Banking markets on both sides of the Atlantic*

Higher fragmentation of the offer combined with less developed demand in Europe translates in structural differences between the European and American investment banking markets. According to the graph below:

- The American investment banking market is more than twice as deep as the European market with an average yearly commission pot of USD 56bn compared to USD 26bn over the 2013 – 2022 period. Furthermore, it is far more concentrated with the top 5 players capturing nearly 40% of the pot in the Americas compared with 25% in the EMEA region.
- Although US market participants are steadily increasing their market share in both American and European markets, European market participants have been gradually losing ground on the American market. A in-depth analysis of the changes in market shares in the European market over the period of 2010 – 2023 reveals that the exit of a European participant benefits (i) players from the same domestic market and (ii) US investment banks, but NOT other European market participants. This illustrates the impact of the fragmentation of European financial markets.



Source: Refinitiv Global Investment banking Review, internal computations

One could draw a parallel with the military concept of strategic depth: US investment banks, which are fewer in number, can rely on a deep and profitable domestic market to deploy their strategy, including towards overseas markets. **In contrast, dispersed European banks have limited room for manœuvre and appear condemned to develop only defensive tactical moves limited to their regional field.**

3) *European banks are penalised by the lack of an active securitisation market*

The absence of a truly active securitisation market (*see below II.2.b. Reinvigorating the European securitisation market*) has a direct impact on the financing capacity of European banks compared to their US peers.

The graph below shows the size of the balance sheet of the main European and US banks, together with their RWA to asset size ratios. The average asset size of the top-20 EU-27 banks is similar to that of their top 20 US peers at around USD 1,000bn. However, the risk density (RWA/asset size) of US banks is on average 50%, compared to 30% for EU-27 banks. This means that, without an active securitisation market, European banks will retain massive low-risk engagements on their balance sheets, while US banks can more quickly recycle their balance sheets. **Lower velocity of their balance sheet not only impacts the return on assets of the EU-27 banks but also directly affects their financing capacity.**

Balance sheet density of US and European banks

Source: Q2 2023 financial statements for the 25 biggest European and US banks

d. Guiding principles of success: a change of mindset

The reforms that will be implemented will be successful if they: (i) make it easier and more beneficial for EU companies to use EU financial markets (ii) ensure that the EU has sufficient strategic autonomy provided by its financial markets and (iii) facilitate long term investments in the EU economy.

In light of the above, a few guiding principles should be systematically considered for the development and assessment of each new reform. These should include its impact on (i) the growth of capital markets, (ii) the competitiveness of EU financial institutions including relative to their competitors outside the EU (*see below II.1.b Integrating a competitiveness test in each new legislation*), and (iii) the relative performance of the EU markets compared to the US, the UK, and Asia. It is crucial for the Union to assess and compare the efficiency of its markets with others, even if each market has its specificities and the comparison between two markets may need to be qualified. By looking beyond its borders and comparing the different segments of its markets, the EU could identify areas of success and development and consider necessary reforms.

Adopting such an approach requires deviating from the principles that have guided the development of EU financial regulation since the global financial crisis, namely the pursuit of financial stability, increased transparency and investor protection. It is important to complement them with other principles that are more favourable to businesses development and risk-taking. In any case, a change of mindset appears necessary to ensure that European markets can fully respond to the financial challenges facing the Union. This means moving away from a consumer-centric approach and considering also the need for the EU to become a market of producers capable of meeting its own needs.

With this in mind, the second part of the note presents concrete proposals to implement this approach.

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II. Proposals for deep and competitive financial markets

This section takes stock of the fact that topics at the core of the functioning of capital markets, such as insolvency rules and taxation systems, will not be harmonized in the foreseeable future and that the establishment of a single supervisor for financial markets is not supported by a majority of Member States.

1. A different approach to EU legislation

a. Harmonising when useful, promoting the sharing of national good practices and encouraging interstate initiatives

The reforms of the first two CMU Action Plans were primarily aimed at harmonising the regulation and supervision practices of EU wholesale markets. However, it is now important to also acknowledge the role that efficient national financial markets can also play. Due to the domestic bias that influences investor decisions, national financial markets are the only one capable of responding effectively to the needs of small and mid-size companies. These companies continue to differ according to their location and national orientation but their contribution to growth and employment is essential. This statement is at least true in the short to medium term and as long as there is no pan European market, which can only truly exist once national markets have reached sufficient size and depth.

EU SMEs are the backbone of the Union's economy

The 20.7 million SMEs in the Union produce 58% of EU GDP and account for 67% of all jobs in the private sector.

While harmonisation is indeed critical for markets where there is a pan-European offer of services, the needs of some economic players such as SMEs can only truly be addressed by a national offer. The market players who are central to such an offer should hence operate under an adequate regulatory framework so that they can respond fully to these needs.

Some national markets have developed specific features to meet these local needs, while others, less mature, have yet to do so. The growth of these markets should be encouraged, while allowing their specific features to co-exist with the more standardised characteristics of larger pan-European wholesale markets. Maximum harmonisation should be pursued only where it is useful and beneficial, while allowing local markets[17] to grow with their own specificities. Full harmonisation should only be an objective once a certain degree of maturity has been reached.

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17 By local markets we mean those segments of the market, whether primary or secondary, addressing the needs of SMEs and retail investors.

The Listing Act: an illustration of the need to foster national practices

In the Listing Act whose negotiations are close to an end, the issue of sponsored research is typical of a domestic initiative that should be nurtured and extended to other markets on an optional basis and with the ability to introduce reasonable variations. In France, where this practice is particularly developed, it is governed by a local code of conduct, which is the result of an agreement struck between the various stakeholders and validated by the French market authority, the AMF. Such a balance was difficult to achieve and required almost three years of work. Encouraging the development of similar codes in other Member States requires striking a delicate balance. On the one hand, some overarching principles should be complied with by all local codes, which ESMA would be better placed to define. On the other hand, having a harmonised EU code risks of being ill-suited to the specific domestic needs of different countries.

The current top-down approach to CMU legislation should therefore be supplemented with a case-by-case bottom-up approach. This approach would provide flexibility to continue and develop useful national practices, particularly in the Union's post-Brexit multipolar financial market. Additionally, it should aim to disseminate these practices to other Member States. ESMA could become a hub for identifying and disseminating national good practices to facilitate their exchange.

Additionally, supervisory practices should be homogeneous for pan-European wholesale markets, but more proportionate for local markets to allow their development.

It must also be borne in mind that some of the reforms now needed to increase the depth and efficiency of EU capital markets are of such a structural nature that they are unlikely to be carried out, at least initially, in 27 Member States. The European Commission, Parliament and the Council must therefore **encourage initiatives between Member States** (in the form of enhanced cooperation or in another format) that will make it possible to create a core of willing countries on each of the axes considered, which will subsequently be able to attract other Member States.

b. Integrating a competitiveness test in each new legislation

The competitiveness of EU actors should be taken into account from the outset of EU legislation and included in the impact assessment. This proposal was made in 2021 by the European Economic and Social Committee in its Opinion[18] on the Renewed CMU Action Plan, which recommended adding an ad hoc competitiveness test in the impact assessment of any new legislation. The test should notably answer the two following questions: *is the proposed legislation having positive effects on the competitiveness of European financial markets and companies and is it helping to strengthen the open strategic autonomy of the EU?*

More generally, the issue of assessing the competitiveness of the EU and the likely impact of regulations on it, should be the responsibility of a dedicated team of economists within the European Commission. This team should span across the Directorate Generals to ensure a comprehensive view.

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18 https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/capital-markets-union-people-and-businesses-new-action-plan

c. Preserving the competitiveness of EU market players in third countries

One aspect of the competitiveness of the EU and its financial actors is their ability to offer services outside EU borders on terms that are attractive or at least not out-of-market.

However, EU firms face a disadvantage when approaching third-country clients in their local markets due to the obligation to apply both EU and national investor protection rules. While it is essential for financial stability that EU financial actors are bound by EU prudential rules wherever they operate, this cannot be the case for rules relating to investor protection, as each third country has its own rules based on its specific needs. Far from being a competitive advantage, the obligation to comply with EU rules is a burden for European-based players. They must adhere to two sets of rules simultaneously, which sometimes result in imposing constraints on clients that discourage them from using their services.

A distinction should therefore be made in the extraterritorial application of EU rules, to ensure that EU investor protection rules do not apply outside of the Union's borders.

MiFIR review: the example of the Derivative Trading Obligation (DTO)

1 January 2021, the uncoordinated application of EU and UK DTOs has led to significant upheavals in the liquidity of instruments subject to the trading obligations, both in the inter-dealer (D2D) and in the dealer-to-client (D2C) markets, reducing the overall global competitiveness of EU-27 financial institutions, especially of their UK branches trading with non-EU clients. Despite the targeted transfer of some transactions to EU venues, US SEFs appear to be the ultimate beneficiaries of the current overhaul of on-venue liquidity and are likely to become even more attractive in the medium to long term.

AMAFI therefore welcomed the EC's proposal to suspend the DTO for EU market makers, at the request of Member States, and in certain circumstances when trading with non-EU clients.

Unfortunately, in the current state of the EU legislative process, this much needed amendment to the regulatory framework will not benefit EU market participants prior to the entry into force of the MiFIR review, although it has been 3 years since the issue was identified and due alerts were escalated to ESMA and to co-legislators.

This case highlights the detrimental impact that the application of EU protection rules in addition to national ones can have on the competitiveness of EU market players. It also highlights the necessity to empower ESMA to be able to issue forbearance letters to suspend the application of EU rules when the European Parliament and the Council agree on the underlying approach, even though the legislative process is not ended yet.

d. Avoiding the systematic revision of EU legislative texts

The flow of financial market legislation has not slowed down since the 2008 financial crisis. This makes it very difficult for market players, especially smaller ones, to make the many necessary adjustments to comply with the regulatory framework. It also tends to instil a bureaucratic approach to the matters at stake. The inclusion of a systematic review clause in every piece of EU legislation is a real issue for the industry and the whole ecosystem. It dœs not allow enough time to consider the impact of what has been implemented and creates regular opportunities for increasing the complexity of an already sophisticated regulatory framework. In addition, it results in highly detailed and technical regulation, which can hardly be mastered without the help of experts, especially within the short time frame

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before the next review. This can be demotivating and create a disconnect from the spirit of the law. It is now necessary to slow down and let firms and national competent authorities ensure the full and harmonized implementation of existing legislation, also for the benefit of clients.

This is especially topical considering the recently completed reviews of MiFIR, CRR2/CRD 5 and AIFMD, all core texts for the industry, and the technical work required for their complete implementation.

MiFIR review: the heavy weight of Level 2 work

MiFIR is a key legislation for our members. Its review will result in a substantial number of Level 2 texts, with around 50 RTS / ITS to be issued by the end of 2025. This will also involve the creation of a consolidated tape. The integration of these changes into the firms' processes will require considerable ressources and attention.

In order to avoid unnecessary constraints on EU actors, the basis of a review should be the existence of proven shortcomings to solve. Any review should therefore be based on objective data as part of a relevant impact assessment that also takes into account the effect of the proposed measures on the competitiveness of market players (*see above b. Integrating a competitiveness test in each new legislation*).

Additionnally, efficiency dictates that the EU legislative process should not be hijacked by too many simultaneous reviews, especially when critical parts of EU legislation are being implemented and require the full attention of the industry as well as of regulators and supervisors. This seems all the more important when we consider the sustainable finance framework, the implementation of which is not only critical but also highly complex, while the urgency is real. Avoiding systematic reviews would allow resources to be allocated to core regulatory issues.

Finally, it is highly important that Level 1 legislation avoid/minimize political discussion being pushed to Level 2. Level 2 should be dedicated to technical calibration. In this way, any adjustment can be done in a targeted way, rather than by reopening the Level 1 text, which should be rarely necessary given that the existing regulatory framework for financial services is already highly comprehensive.

e. Reforming ESMA's mandate and governance

Adding competitiveness to the ESMA's mandate

The EU's concern for competitiveness must translate into a radical change of approach, which should be reflected in the very mandate of the supervisory authorities, as they play a fundamental role in the development and implementation of regulation. In this way, the ESAs' mandates, and in particular the one of ESMA, should be modified. The objectives set for by the regulation establishing it (Regulation (EU) 1095/2010, Art. 1.5) should be modified: alongside the contribution to *"ensuring the integrity, transparency, efficiency and orderly functioning of financial markets"* and to *"enhancing customer and investor protection"*, ESMA's mandate should include *"ensuring the competitiveness of the financial markets"*.

This should lead ESMA to consider competitiveness when it is engaged in rulemaking or supervision, from both the internal perspective and outside of the EU.

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Competition in the mandates of other regulatory authorities

The role of the US SEC in respect of competition is enshrined in four of the US Securities Acts, containing the following language: "*Whenever . . . the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.*"

The mission of the Commodity Futures Trading Commission "*is to promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation*"; its chairman stated in its 2022-2026 strategic plan that his "*belief about what success looks like for the CFTC is "fostering open, transparent, competitive, and financially sound markets (…)"*[19].

Efficiency, competition and vibrancy of markets are intertwined concepts, which should also instil ESMA's mandate.

The Financial Services and Markets Act of 2023 introduced a secondary objective to the mandates of the UK Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), which is to "*facilitate the international competitiveness of the UK economy (including, in particular, the financial services sector), and its medium to long-term growth, subject to aligning with relevant international standards*". The FCA reports yearly on how it complies with this objective using detailed metrics[20].

▸ *Towards a more pragmatic governance*

At a time when firms need to adapt quickly in a fast-changing environment, ESMA needs to be able to be reactive and agile in its decision-making process. This is the reason why AMAFI believes that ESMA's governance needs to be fundamentally reformed to strengthen its decision-making power and make it more adaptable.

- **Changing the decision-making process of the Board of Supervisors (BoS)**

  In taking decisions, the BoS members face two particular challenges: firstly, the need to understand issues that are often highly technical; and secondly, the need to ensure that national interests do not unduly interfere. As such and while simple majority voting may appear to be the most "democratic" approach, it dœs not reflect the reality of financial markets in Member States, which vary widely in size and complexity. For this reason, we believe that new voting arrangements should be considered that reflect the heterogenous weight of the financial markets of the Union and the different areas of expertise of each national market authority. We also consider that, as it is the case with simple majority voting, abstentions should never count as a vote for or against, regardless of the matter being voted on.

- **Replacing the existing Management Board with an Executive Board**

  Echoing the governance of the upcoming Anti-Money Laundering Authority, AMAFI considers that an Executive Board composed of a few selected members would enable ESMA to take some decisions more efficiently.

19 https://www.cftc.gov/media/7081/CFTC2022_2026StrategicPlan/download

20 https://www.fca.org.uk/publication/corporate/secondary-international-competitiveness-growth-objective-statement.pdf

The main objective is to provide ESMA with a decision-making process that is better guided by concerns for the smooth functioning of financial markets, limiting potential political and national interferences. Such a development is of paramount importance not only for the agility of the decision-making process but also to reinforce the international stance of the Union.

Towards ESMA's direct supervision

Firms with pan-European operations report encountering varying approaches from different NCAs. This hampers their competitiveness, as it becomes more arduous to establish common processes and tools that would allow them to reduce the cost of their services and products for investors and issuers. There would be benefits from a supervisory, business (time to market related considerations) and level playing field perspective to bring these actors under the single supervision of ESMA.

Unfortunately, at this point, it dœs not appear feasible to pursue such an initiative through a binding text that would translate into direct supervision by ESMA of all market participants. Primarily, because many, if not most, Member States are unlikely to concede the transfer of sovereignty that would be implied by the acquisition of such generic direct supervisory powers by ESMA. Additionally, direct supervision at the European level may not make sense, or bring the same value, for all players of a given sector. Lastly, it is important to note that ESMA would need to acquire the required expertise and resources to execute any new direct supervision, which will hence need to be part of a gradual approach.

Therefore, AMAFI suggests an approach whereby, for those sectors of activity which the European authorities would consider to be a priority, ESMA supervisory powers would be enhanced for the sectors in question: ESMA would be responsible for the supervisory framework and would perform direct and indirect supervision of actors according to relevant criteria (significance of the business, cross-border activities...). Consideration could be given, alternatively, to a system under which market participants could express, as part of this framework, their interest in being placed under the direct supervision of ESMA. The conditions under which this mechanism would operate would need to be defined to guarantee that ESMA can respond to transfer requests and perform both its direct and indirect supervisory duties effectively, and to ensure that a level playing field is guaranteed throughout the sector concerned by this possibility.

Whilst such an approach might be considered to contribute to the fragmentation of EU capital markets, it could on the contrary, if managed within a consistent framework, bolster the competitiveness of market players with pan-European operations and reduce fragmentation in supervisory practices. This approach would also provide for some flexibility, as it may be more efficient for smaller entities with local operations to remain under the direct supervision of their NCA, in direct coordination with ESMA.

In the medium to long term, AMAFI considers that Single Supervision in Europe must be the ultimate goal, as it is a condition to the effective union of capital markets. It is imperative to eliminate uncoordinated national exemptions and prevent domestic gold plating of EU law to deliver a Single European Rulebook. This necessitates a strengthened ESMA, able to promote close collaboration and alignment amongst national supervisors to promptly and decisively intervene in instances of diverging regulatory practices.

f. Increasing the agility of the EU legislative process

It is of the utmost importance for the EU to find a solution to increase the reactivity of its legislative process: this is a question of the competitiveness of its market players vis-à-vis third-country jurisdictions that are usually more agile from a legislative perspective.

Presently, there is a significant delay between the adoption of an EC proposal and its publication in the EU Official Journal. This can be detrimental to the business of EU market players when the matter at stake is time sensitive and affects their ability to provide services to clients. This can result in losing clients to competitors operating in a jurisdiction without such a restriction on their service offering.

The Union should have the rights tools to bring flexibility to the currently rigid legislative process. In this respect, AMAFI proposes broadening the scope of the no-action letter that can be issued by the ESAs, ESMA in particular, to come closer to the prerogatives of the SEC in the US.

EMIR 3.0: exemption of clearing obligation for third party pension scheme arrangements

The exemption from the clearing obligation that was granted to OTC derivatives entered into by to pension scheme arrangements (PSA) under Article 89 of EMIR initially until 16 June 2019, then extended by a European Commission Delegated Act, has come to an end on 18 June 2023.

While OTC derivatives entered into with EU pension scheme arrangements (PSA) are now subject to the clearing obligation, the EC proposes through EMIR 3.0, to extend this exemption specifically to contracts with third country PSAs when they are exempted under their own regulatory framework (e.g. UK PSA).

To ensure a level playing field between UK and EU actors, it is essential from a competitiveness perspective that a forbearance be provided up until EMIR 3.0 enters into force.

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2. Two essential reforms to develop the EU financial markets

This section focuses on two axes of reform that we consider should be prioritised between 2024 and 2029.

In our opinion, these two axes are essential for the deepening of EU capital markets. They are truly structuring and will have consequences beyond capital markets, on certain societal choices and on the European integration methods. It is therefore unlikely that a sufficient consensus can be quickly reached between the 27 Member States. A sufficiently progressive and inclusive approach, **based in the first instance on initiatives between Member States or on optionality,** should therefore be preferred, as mentioned in point II. (*see above 1. a Harmonising when useful, promoting the sharing of national good practices and encouraging interstate initiatives*).

Although this aspect is not developed hereafter, thought could also be given to making the implementation of European policies more effective through the involvement of the EU's supra-sovereign institutions (e.g. European Investment Bank). The aim would be to complement the regulatory aspect of these policies with public action pursuing the same objective, which will act as incentives and catalysts to reach the pursued objectives (see below the example of the role that such an actor could play in securitisation, *II. 2. b. Reinvigorating the European securitisation market*).

a. Channelling savings towards long term investment

We share the objective of the Retail Investment Strategy (RIS) to improve the access of EU households to financial markets, as a way to improve the performance of their savings and increase their wealth.

Ensuring a properly calibrated RIS to meet retail investors needs and enable competitiveness

The RIS proposal is anchored on a cost-focused approach. However, simple products at low cost cannot be considered as the only answer to the diversity of profiles and needs of retail investors. This is all the more important given the need to channel EU households' investment towards ESG products, which are generally neither the simplest nor the cheapest products.

In addition, a number of the proposed reforms of MiFID II and PRIIPs could have a detrimental effect on the competitiveness of EU markets, limiting the choice available to retail investors and ultimately reducing their appetite to invest in financial markets[21].

The performance of financial instruments and the quality of the services offered should be core criteria for the calibration of the RIS. We therefore call on the EC and the co-legislators to recalibrate the RIS and in particular to remove the partial ban on inducements and the best interest test and to consider expected performance as the first criteria for determining the different benchmarks of the Value for Money, with costs coming after.

Beyond RIS, AMAFI strongly believes that direct and spontaneous investments by individuals are unlikely to result in significant flows of money, and even less so in risky assets especially since the regulatory framework discourages such risk-taking. However, the EU economy needs long-term and stable investments that involve a certain level of risk-taking. This need is far from being satisfied as illustrated by the Union's significant investment gap.

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21 For further details please refer to AMAFI / 23-70

In the United States, and to a lesser extent, in the UK, financial markets provide a reliable source of deep and stable financing for companies. This is largely due to pension funds, which trigger massive investments in equities, as highlighted by the chart below.

US and UK pension funds assets allocation strategy in 2021

Source: Global Pension Asset Study 2022

While such pension systems do not exist in most EU Member States, a question should be asked as to how long-term funding could be incentivised by the EU. Taking into account that the development of pension funds mainly remains in the remit of Member States, the European Commission could design incentives for the development of alternative investment vehicles that would effectively transform a sufficient share of European savings into capital for EU companies and structural projects, and hence contribute to closing the investment gap.

Developing incentives to long term investment in EU companies

In order to channel savings towards the capital of European companies and to encourage long-term investment, the Union could develop a European Transfer Savings Plan (ETSP) that would be exempted, up to a certain amount, of transfer duty on inheritance, provided it is invested in equities of EU companies, particularly SMEs, and a minimum holding period of several years is complied with. Such instrument should be designed under a pan-European regime, with similar features and unique supervision across the Union. Given that taxation remains a national competency, Member States would be free to refuse authorising the ETSP, but they could be incentivised to adopt it, for instance by making sure that only the amounts invested in the capital of companies registered in Member States adhering to the ETSP are eligible for the transfer duty relief.

Finally, experience shows that retail investment in capital markets greatly depends on tax incentives. We note that, in the EU, most domestic markets where retail investors have a portion of their savings invested in shares, have indeed implemented tax relief schemes. While a good regulatory framework and financial literacy can play a role in attracting retail investors to capital markets, the most effective way to increase their participation would be for the European Commission to strongly encourage Member States to develop plans to develop such investment. These could include tax incentives where possible[22], although we recognise the budgetary constraints of Member States.

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22 As highlighted by R. Buenaventura in his opening remarks at Eurofi: https://www.cnmv.es/WebServices/VerDocumento/Ver?t=%7B4310787c-6640-428d-a593-3d0bbf4f1ec0%7D

b. Reinvigorating the European securitisation market

While financial markets should play a greater role in financing the EU economy, bank lending remains essential for certain projects and businesses, especially SMEs. In this context, and also considering that bank lending is currently the main source of funding of the EU economies, securitisation is a necessary tool to increase banks' ability to provide credit while offering investors a greater variety of investment opportunities. As highlighted by ECB President, Christine Lagarde, in one of her recent speech: "*A genuine CMU would mean building a sufficiently large securitisation market, allowing banks to transfer some risk to investors, release capital and unlock additional lending. In the United States, banks have access to a securitisation market that is three times the size of Europe's. This could be even more powerful in our bank-based financial system.*"[23]

However, securitisation remains largely underdeveloped in the EU due to regulatory constraints. This is a crucial issue for the competitiveness of EU banks vis-à-vis their third-country counterparts *(see above I. c. Fostering competitive EU capital markets)*, but also, and above all, a strategic issue for the Union's financing autonomy.

The EU securitisation market

As illustrated in the 2022 ESRB[24] report, the EU securitisation market at around € 0.7 trillion in the second quarter of 2021 is much smaller than the US one of around € 9.8 trillion. Since the global financial crisis, the EU market has shrunk by around 40%. In the second quarter of 2021, the EU securitisation market represents around 2% of the total assets of the EU banking system.

Decisive action by the EU authorities is therefore needed to promote the development of the EU securitisation market, similar to that which has benefited other market segments (covered bonds, government bonds, corporate bonds). The regulatory framework for securitisation should be reviewed, in particular the STS Securitisation Regulation and the Capital Requirements Regulation (CRR), in order to:

- review the eligibility criteria of securitised assets as collateral for the Euro system market repo operations and for the ECB's purchase programmes;
- simplify the Significant Risk Transfer assessment process;
- adjust the prudential treatment of securitisation for banks and insurers;
- allow the development of synthetic securitisation;
- upgrade the eligibility of securitisation in the LCR ratio; and
- differentiate between public and private securitisations for disclosure purposes.

In addition to increasing the much-needed capacity of EU banks to accelerate the rotation of their assets, a developed and vibrant European securitisation market would help create a safe asset[25] at the level of the Union, especially if it is supported by a well-calibrated **pan-European guarantee scheme.** Such safe asset would be the backbone for the deepening and integration of EU capital markets, an attractive factor for third country investors and a catalyst for the role of the EU in the world. We hence encourage European authorities to consider the implementation of such guarantee scheme, for instance at the level of the EIB.

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23 https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp231117~88389f194b.en.html

24 https://eurodw.eu/wp-content/uploads/esrb.report_securisation.20220701_27958382b5.en_.pdf

25 Securitisation of banking assets or sovereign debt within the limit of the Stability and Growth Pact.

Find out more about this report on
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