

Embedding the competitiveness of EU market actors and the attractiveness of EU markets as core objectives of CMU legislations

The sanitary crisis, Brexit as well as an unstable geopolitical environment have underlined **the necessity for the Union to develop and strengthen its Open Strategic Autonomy** which we would define as “the ability to act autonomously, to rely on one’s own resources in key strategic areas and to cooperate with partners whenever needed”¹. To that end the financial sector and financial markets in particular have a critical role to play.

The Covid-19 health crisis has severely impacted the EU-27 economy and caused debts to surge, increasing the need for the EU to bolster its market-based financing capacity, not just to support the economic recovery but also to regain some autonomy in sectors the crisis has led to identify as strategically important.

Besides, with Brexit, the EU must rethink how its financial markets operate so that it can maintain control over an ecosystem that is vital to financing its economy. The EU is facing an unprecedented challenge where for the first time it has such a strong competitor at its door. This is all the more preoccupying as, since the global financial crisis, its financial services actors have gradually lost market shares to the benefit of their Anglo-Saxon peers (*for further details, see Appendix 1*).

While the need for the EU to take control of its economic and industrial destiny through the strengthening of key sectors has been clearly identified by the European Commission (EC)², it does not seem to be entirely the case for the financial sector.

Admittedly, the draft conclusions of the March ECOFIN are expected to set out a vision for a Europe autonomous in financial services building off the 2021 EC’s paper on financial sovereignty³. They will likely underline the necessity to develop the Union’s autonomy notably with regards to third-country critical services providers, non-European data providers as well as the need to reduce reliance on foreign financial institutions.

These are positive steps, but we consider that European authorities need to move several steps beyond, by setting **the necessity to improve the competitiveness of EU market actors and the attractiveness of the EU regulatory framework as a core priority**. The development of EU champions in particular in the CIB area should be a central objective. The EU-27 cannot strongly rely on offshore resources for the financing of its economy which are legitimately repatriated to their home markets in crisis times. This was the case during the 2011 Debt Crisis and more recently at the height of the covid-19 pandemic crisis in March 2020.

Fostering the growth of EU champions in the financial sector is key to support the economic recovery, to finance the transition towards a decarbonized and digital economy as well as to support the adaptation to an ageing European population.

Complementing our previous reflexion on this topic ([AMAFI / 21-38](#)), this note aims to emphasize the necessity (i) to accelerate the Union’s transition from a banking to a market-based financing model in light of its financing challenges and (ii) to put the competitiveness of EU actors and the attractiveness of EU markets at the heart of upcoming CMU legislations.

¹ [https://www.europarl.europa.eu/RegData/etudes/STUD/2020/652096/EPRS_STU\(2020\)652096_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2020/652096/EPRS_STU(2020)652096_EN.pdf)

² https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_22_354

³ https://ec.europa.eu/info/publications/210119-economic-financial-system-communication_en

I. Accelerating the Union's transition from a bank to a market-based financing model

a. Bank lending remains core to EU's financing despite heavy prudential constraints

6 years and a half after the launch of the CMU project, bank lending remains core to the financing of the EU's economy (*for further details, see Appendix 2*). **In 2018, it represented 56% in the Euro zone compared to only 10% in the US⁴.**

While the new prudential regime implemented after the 2008 financial crisis has made EU banks safer, better equipped to absorb structural shocks – as illustrated during the covid-19 pandemic –, it has also impacted their profitability and their capacity to distribute credits. These are direct consequences from the increase in relative terms of CET1 capital ratio that has particularly hit European banks compared to American ones (*for further details, see Appendix 3*).

This is all the more preoccupying as the Union is facing massive investment challenges.

b. The Union's four main financing challenges

The economic recovery

As a result of the Great Lockdown, Member States faced a double shock of supply and demand. In this context, economies of the European Union and of the Eurozone contracted respectively by 5.9% and 6.4% in 2020⁵. To support their economies, EU governments and Heads of States have taken fiscal measures and launched guarantees programs, increasing massively **the public debt-to-GDP ratio to reach 90.1% in the EU (77.2% end 2019) and 97.3% in the Euro area (83.6% end 2019)**⁶. At the same time European companies, from SMEs to large groups, have increased their indebtedness.

While EU banks have been instrumental in the immediate reaction to the pandemic to finance the Union's economic recovery, financial markets⁷ will also have a key role to play in the medium to long term, (i) to refinance public debt, (ii) to help corporate companies raise capital to restore more decent leverage ratios and (iii) to free banks' balance sheets so they can allocate further resources to the financing of the economy, and especially to SMEs for which bank credit is often a central, if not sole, source of financing.

The mitigation of climate change

The EC adopted in July 2021 its renewed Sustainable Finance Strategy⁸ emphasizing **a financing need of EUR 350 billion per year to meet the 2030 emissions-reduction target in energy systems alone and EUR 130 billion for other environmental goals.**

The fourth industrial revolution

In the fourth industrial revolution, Europe stands far behind the US and China. While the EU's GDP is almost one fourth of the world GDP, **the Union is only home to 10% of global technology emerging firm**⁹. Currently, the EU financing scheme (*i.e.* venture capital and equity) is not as efficient as it should be, especially compared to the US market. The EC evaluates the **annual funding gap for the digital transformation at EUR 125bn**¹⁰.

⁴ Réinvestir le secteur bancaire européen, Institut Montaigne, November 2021, [link](#)

⁵ <https://ec.europa.eu/eurostat/databrowser/view/tec00115/default/table?lang=en>

⁶ https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Government_finance_statistics

⁷ NextGenerationEU is already a concrete example of the central role played by financial markets in order to support the EU's economic recovery in various domains including energy transition and digital for a total amount of EUR 806.9bn.

⁸ https://eur-lex.europa.eu/resource.html?uri=cellar:9f5e7e95-df06-11eb-895a-01aa75ed71a1.0019.02/DOC_1&format=PDF

⁹ Financer la quatrième révolution industrielle, Philippe Tibi, Juillet 2019, [link](#)

¹⁰ Commission Staff Working Document « Identifying Europe's recover needs », [link](#)

The ageing of the population

According to the EC, the 65+ population as a percentage of the population aged 15-64 is expected to increase to 53% in 2060. The **total cost of ageing, which was at 24% of GDP in 2019, is expected to rise by 1.9 pps. of GDP in the EU by 2070. In the euro area, it is projected to rise by 1.7 pps.** over the same period.

The importance of the financing needs and the regulatory burden weighing on the EU's banking sector lending capacity makes the development of the CMU and EU champions in the CIB sector key to avoid relying too much on third country capital which could take ownership of companies in strategic sectors of the European economy. This is even more necessary as the City is no longer the EU main financial center.

c. Brexit as a game changer

Before Brexit, the UK was the EU's main financial center around which the financing of the European economy has largely revolved (*for further details, see Appendix 4*). This means that the impact of Brexit is twofold: (i) the EU lost its dominating financial center, creating an unprecedented challenge to reconfigure its financial markets, and (ii) the Union, that used to manage relations with other marketplaces that were either massive but distant (like the US) or close but relatively modest (like Switzerland) now has a massive competitor at its doors.

In that context, **the first phase of Brexit was apparently in favor of the Union** with:

- (i) The shift of volumes in EU shares and EUR denominated derivatives from the UK to the EU-27 (*for further details, see Appendix 5*); and
- (ii) Third country financial firms having adapted their European setup to account for the loss of passporting rights through the creation of new entities in the EU-27, the transfer of capital resources from the UK to the EU-27 and the relocation of jobs.

The long-term outcome of the second phase is much more uncertain and, as things currently stand, seem more favourable towards the UK, that can use its renewed legislative and regulatory agility, and has already shown concrete proofs of its willingness to diverge from the EU regulatory framework. In fact, British authorities have put the competitiveness of their marketplace as a core objective of upcoming legislations as illustrated by the Wholesale Markets Review¹¹, the UK Listing Review¹² and the Regulatory Framework Review¹³.

The Union should therefore reconsider the main objectives of upcoming CMU legislations.

II. Adapting the objectives of CMU legislations to a new political, economic and financial reality

a. The Union's current approach

The departing point is hardly favorable to the Union: **there are no pan-European champions in CIB able to compete with their US peers and the EU-27 financing model remains bank-based.**

One of the main reasons for that situation is that the **issues affecting the competitiveness of EU market participants and the attractiveness of EU financial markets have only been addressed in a reactive mode.** Absent a significant overhaul of the EC's approach when elaborating new legislations, upcoming reforms will continue to create new hurdles for EU markets' participants.

¹¹ "This consultation is part of the Chancellor's broader vision to enhance the competitiveness of UK capital markets, while maintaining high regulatory standards", HMT Consultation, July 2021

¹² "You should produce a short annual report on the state of the City, to Parliament, that sets out the progress that has been made in improving our competitive position over the previous period", Lord Hill's report

¹³ "The government therefore intends to provide for a greater focus on growth and competitiveness by introducing new, statutory secondary objectives for the PRA and the FCA", HM Treasury Proposals for reform

Indeed, European authorities mostly amend regulations only after they have proven detrimental to the attractiveness of EU markets and to the competitiveness of EU market participants – recent examples would include the ability of insurance companies to invest in capital under Solvency, or the extra-territoriality of the derivative trading obligation under MiFIR as highlighted below.

The extraterritoriality of the Derivative Trading Obligation

Since 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 interdealer (D2D) and in the dealer-to-clients (D2C) markets, overall reducing the global competitiveness of EU-27 financial institutions especially for their UK branches trading with non-EU clients. It is also noticeable that, alongside the targeted transfer of some transactions to EU venues, US SEFs already appear as 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.

As such we welcome the EC proposal to suspend the DTO, upon member state request for EU market makers, under certain circumstances when trading with non-EU clients.

However, given the expected length of the EU legislative process before the entry into force of the MiFIR review and given the urgency to enable UK branches of EU firms not to apply anymore the EU DTO when trading with non-EU clients, we are calling for a fast implementation of this provision to restore the competitiveness of EU investment firms.

b. Proposed way forward

In this context, we would make three recommendations:

- (i) Urge for the competitiveness of EU actors and attractiveness of EU markets to feature prominently from the inception of CMU and other financial services legislations at the same level as financial stability, market integrity and investor protection;**
- (ii) Support the proposal laid out in the 2021 Opinion¹⁴ on the Renewed CMU Action Plan of the European Economic and Social Committee, which advises integrating an ad hoc competitiveness test in the impact assessment of any new regulation;**
- (iii) Envisage to have the promotion of attractiveness and competitiveness embedded in the ESAs statutory objectives.**



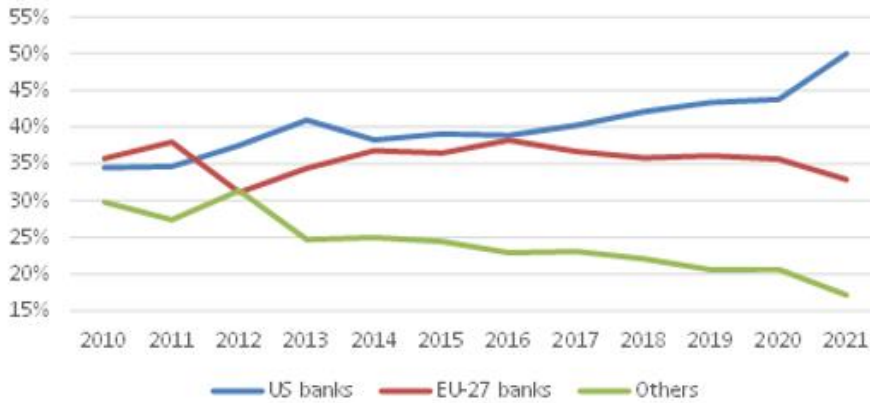
About AMAFI

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.

¹⁴ <https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/capital-markets-union-people-and-businesses-new-action-plan>

Appendix 1 – Split of the commission pot earned by the top 20 banks on the European IB market

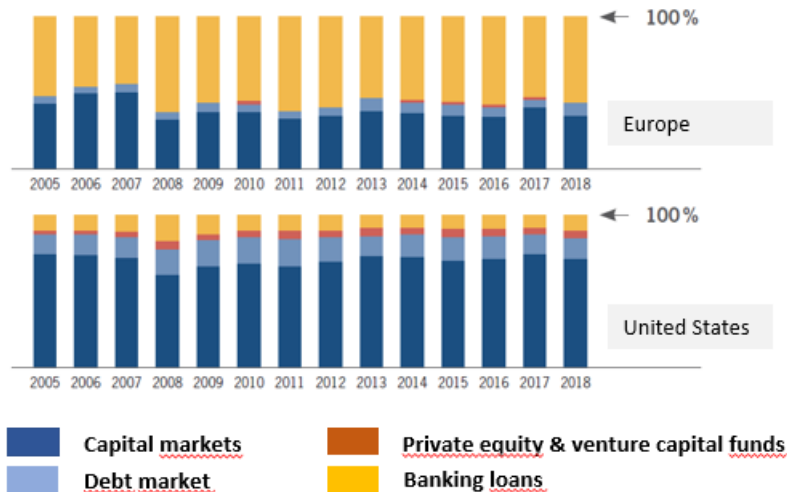
Split of the commission pot earned by the top 20 banks on the European IB market



Source: Refinitiv, internal computations

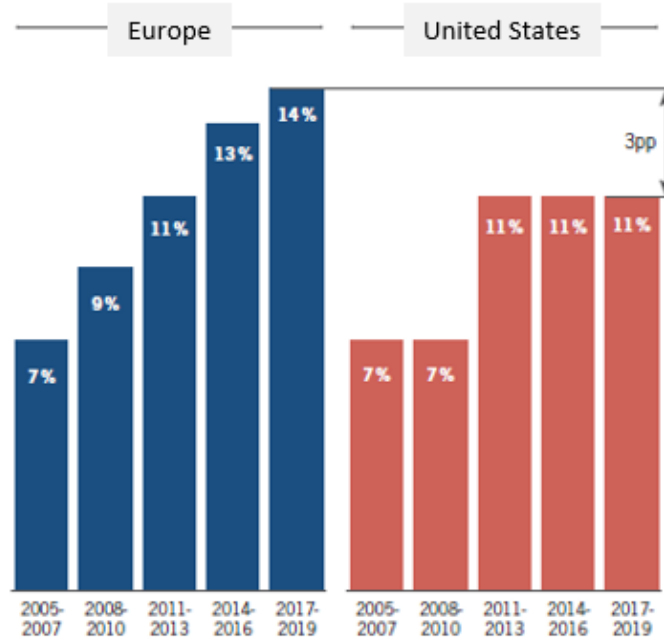
Appendix 2 – Distribution of non-financial corporations’ financing means in % of total financing volumes

Distribution of non-financial corporations’ financing means in % of total financing volumes



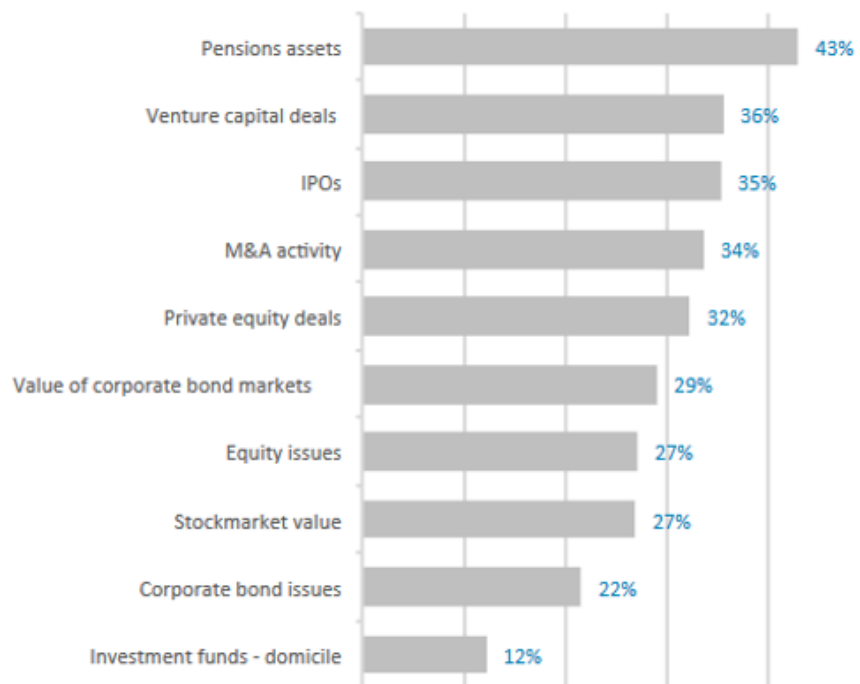
Source : World Bank, IMF, Preqin, Pitchbook, Analyse BCG, from "Réinvestir le secteur bancaire européen, Institut Montaigne"

Appendix 3 – Evolution of CET 1 capital ratio in Europe and in the United States



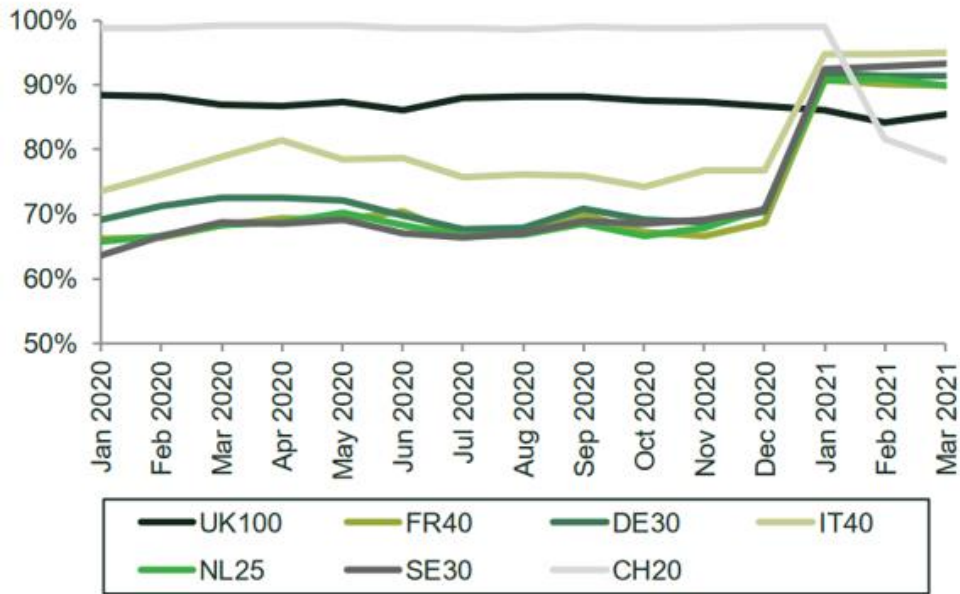
Source : S&P SNL, Analyse BCG, from "Réinvestir le secteur bancaire européen, Institut Montaigne"

Appendix 4 – Proportion of EU capital markets activities that was conducted in the UK prior to Brexit



Source : New Financial « What have the capital markets ever done for us? », February 2017

Appendix 5 – Proportion of on-venue trading in domestic jurisdiction in shares of main EU indexes



Source : Oxera, *The landscape for European equity trading and liquidity*, May 2021