CEPS

ECMI EUROPEAN CAPITAL MARKETS INSTITUTE

ecri EUROPEAN CREDIT RESEARCH INSTITUTE

TASK FORCE REPORT

STAYING AHEAD OF THE CURVE

Shaping EU financial sector policy under von der Leyen II

Chair

Jesper Berg

Rapporteurs

Karel Lannoo
Apostolos Thomadakis
Judith Arnal

CEPS is an independent think tank based in Brussels. Its mission is to produce sound policy research leading to constructive solutions to the challenges facing Europe and the world. ECMI examines capital markets policy and ECRI credit markets and retail finance policies. They are both separate entities managed by CEPS.

This report builds on the debates of the CEPS Task Force on 'EU financial markets in 2030: A roadmap for the next European Commission'. The members of the Task Force participated in extensive discussions over the course of several meetings and submitted comments on earlier drafts of the report. The recommendations of this Task Force do not necessarily reflect a common position reached by all members. Nor do they represent, in any manner, the views of the institutions to which the members belong. A list of members, meetings and speakers are in the appendices.

The members and rapporteurs wish to thank the chair, Jesper Berg, former Director-General of the Danish Financial Services Authority, for his guidance and insights. The rapporteurs are indebted to the Task Force members and observers for their input and detailed comments, which have added value and balance to the final report. They also acknowledge the administrative assistance of Alice Orlandini and Beatriz Pozo, and the editing expertise of Kathleen King.

Suggested citation: Lannoo, K., Thomadakis, A. and Arnal, J. (2024), *Staying ahead of the curve: Shaping EU financial sector policy under von der Leyen II*, Task Force Report, Centre for European Policy Studies, European Capital Markets Institute and European Credit Research Institute, Brussels.

978-94-6138-796-7

Image credit: www.vecteezy.com

CEPS, ECMI and ECRI

Place du Congrès 1, B-1000 Brussels

Tel: 32 (0) 2 229 39 11

email: info@ceps.eu and ecmi@ceps.eu

internet: www.ceps.eu, www.ecmi.eu and www.ecri.eu

CONTENTS

FIGURES

TABLES

FOREWORD

It has been a pleasure and an honour to chair the CEPS Task Force on EU financial markets in 2030. This report reflects the input of a group of dedicated Task Force members and the no less dedicated efforts of CEPS staff.

We all want Europe to progress, and we believe that Europe has the capacity to do so. Financial markets can make a positive difference, but they can also cause economic setbacks. The question is how we ensure the former and avoid the latter.

The single rule book has grown and become too complex. There are valid reasons for every single paragraph, and this report is not a call for lowering regulatory standards. However, we need to pause and consider whether we can simplify without lowering standards.

The Capital Markets Union is a focus area. Europe will clearly benefit from deeper capital markets, but it should not come at the expense of the depth of our banking sector. Many of the initiatives under the Capital Markets Union umbrella seem unlikely to make a substantial difference. The key seems to be to encourage savings in a form that is suitable for capital market developments.

There is also unfinished business in the banking area. The most important issue here is that we do not have a well-functioning resolution framework. There is still a very high likelihood that the bill for a failing bank will land on the taxpayer.

Thus, the next Commission will have to both move forward and to consolidate. Therefore, it is important that the next Commission focus on the initiatives that can really make a difference. We hope this report will help in this respect.

Jesper Berg
Chair of the Task Force
Former Director-General
Danish Financial Supervisory Authority

EXECUTIVE SUMMARY

If Europe wants to stay ahead of the curve and be able to follow its international counterparts, the von der Leyen II Commission should have a focused agenda that balances regulatory simplification with forward-looking strategies. This is particularly the case in areas of capital market integration, bank competitiveness, digital finance, and sustainability.

Over the past decades, Europe's financial system has grown in size and complexity but remains largely bank-centric compared with more market-oriented systems. Key efforts have been made to diversify, deepen and integrate financial markets in the EU, including significant legislative initiatives like the Capital Markets Union (CMU) and the Banking Union. But progress remains uneven and has stalled on some files. Europe is still facing fragmented banking systems and market infrastructures, as well as inconsistent regulatory enforcement across Member States. Simplification of the EU's financial rulebook and harmonisation of supervisory frameworks are essential to foster growth without compromising financial stability.

EU capital markets lag behind other international markets. Europe has a low share of global equity and corporate bond markets, and fewer risk-capital investments. While the CMU has driven some improvements, hurdles like limited integration and low participation by retail investors remain, requiring further regulatory action to increase market depth and investor confidence.

Europe's banking sector, although large and well-capitalised, suffers from lower profitability, fragmented regulations and valuation disparities compared with global counterparts. The incomplete implementation of the Banking Union further compounds these issues. Uneven playing field practices when financial institutions fail, the absence of a common backstop to the Single Resolution Fund, a liquidity provision mechanism in resolution, and the lack of a European deposit insurance scheme, present significant risks to long-term financial stability.

The intersection of digital innovation and sustainable finance presents both opportunities and challenges. The rise of fintech, artificial intelligence and sustainable financial products requires a recalibrated regulatory approach to balance innovation with prudential oversight, ensuring the EU remains competitive globally while meeting its digital transformation and green transition goals.

Enhancing the global competitiveness of EU financial markets calls for prioritising regulatory reforms that foster innovation, reduce costs and promote cross-border investments. A comprehensive review of the financial services landscape is necessary to address structural inefficiencies, ensure market dynamism and support long-term economic growth.

INTRODUCTION

Financial markets have been the object of intense regulatory activity over the last 25 years. Starting with the Financial Services Action Plan (FSAP), activity then increased in response to the financial crisis, with the establishment of the European Supervisory Authorities (ESAs). Further developments have ranged from the Banking Union and creation of the Single Supervisory Mechanism (SSM) to the launch of the Capital Markets Union (CMU) and the beginnings of the sustainable finance agenda. Altogether, these developments, aimed at ensuring trust in the integrity and functioning of financial markets, have been nothing short of a regulatory roller-coaster. Financial legislation has grown very dense with numerous references to secondary legislation and periodic review clauses as standard in almost all pieces of regulations.

Given the high regulatory intensity of the EU, the intention of policymakers – and the expectation and desire of markets and observers – is for a regulatory pause. After many waves of financial regulation, the competitiveness of the EU economy has become a prominent issue in the public debate on Europe's future. This raises the question of how to strike the right balance in regulation – one that fosters competitive financial services while avoiding unacceptable risks to investors and consumers and maintaining orderly, well-functioning markets.

The outlook for different segments of the financial industry is mixed and priorities differ depending on business models and risk profiles. The need for a more attractive capital market features high on the policy agenda. The Eurogroup adopted a plan for a real Capital Markets Union and a special European Council held in April 2024 dedicated an important part of its conclusions to the topic. The report on the single market by former Italian Prime Minister Enrico Letta (Letta, 2024) has truly integrated financial markets at its core, with a savings and investment union. Under the chairmanship of the Honorary Governor of the Bank of France, Christian Noyer, another special report was produced on the matter (Noyer, 2024). In sum, new actions are implied.

It is evident that EU capital markets are not as developed as US capital markets, and that further development would benefit the EU economy. However, the strengthening of EU capital markets should not be at the expense of financial stability and the objective of orderly functioning markets. It must be recognised that the EU financial market structure differs from other jurisdictions. For instance, the EU has a relatively large banking system, which provides substantially more credit to the economy than the US banking system does to the US economy. The EU banking system with its many features is of great importance to the EU economy.

EU banks are underperforming US banks in terms of valuation at present, but it is not a success criterion in itself that banks trade at high price-to-book ratios. Banks exist within the financial system to provide services to the economy, and their performance is a reflection of the broader economic conditions, with the US economy – at least for now – experiencing stronger growth.

The economic performance of EU banks should not endanger financial stability or the services that banks render to the economy. In addition to low demand for banking services because of a subdued economy, it can be argued that there is excess supply because of (i) lack of adoption of failing or likely to fail decisions; (ii) solutions outside resolution such as State aid, including precautionary recapitalisation and preventive measures; and (iii) incentives created by the interplay of resolution with alternative solutions such as insolvency and alternative measures in insolvency.

Furthermore, EU banking regulation could benefit from greater proportionality in terms of its detailed requirements, ensuring that smaller institutions face fewer unnecessary burdens without reducing overall stringency. This approach should maintain financial stability and preserve a level playing field across the sector.

Many regulations are still being implemented, however, with secondary pieces only kicking in or presently under discussion. Five-year review clauses are contained in many EU regulations, implying possible follow-up. And work remains to be done in financial markets, as a result of outstanding issues from previous mandates, market developments and aspects that have remained outside harmonisation efforts.

It is an illusion that simplification or consolidation of legislation can be achieved easily. The current financial rules have (mostly) come about as an outcome of long and protracted debates. Changing or taking away some elements can change the steady state and provoke new discussions. Amending one aspect can have implications for other strands of regulation or impact contractual terms. The experience in the UK of 'onshoring' some EU rules since its withdrawal provides a sobering reference.

In addition, there is the increasingly transversal nature of rulemaking: digital and sustainability regulations intersect with finance, and a holistic approach is needed to assess the overall impact of new rules. Policymakers and companies need to take an integrated approach to the management of regulatory change. This leads us to questions of what to expect and what to recommend for the new mandate of the European Commission, the European Parliament and the EU Council.

This report starts with a discussion on the value of regulation, followed by an analysis of developments in European financial markets over the last years. It then moves on to review the achievements at the EU level in financial market regulation and related areas, and the priorities emanating from them. The report then looks at achievements in the supervisory field. Finally, proposals for moving forward are presented.

1. WHY AND HOW SHOULD THE FINANCIAL SYSTEM BE REGULATED?

- The financial system plays a critical role in facilitating spending, investments and risk diversification but can also amplify economic disruptions, as seen in past crises.
- Balancing regulation is crucial; too much regulation can stifle growth, but too little can expose economies to systemic risks, particularly in emerging sectors like crowdfunding and cryptocurrencies.
- Information asymmetry and societal design (e.g. creditor and shareholder protections) shape the financial system and influence access to credit and market development.
- Regulation complexity has grown, disproportionately affecting smaller institutions, highlighting the need for simplification without compromising financial stability.
- The primary goal should be to foster a financial system that maximises economic welfare and contributes to sustainable transitions, rather than simply focusing on financial sector growth.

The financial system plays an important role in an economy. It can deliver tremendous social benefits and help to finance priorities such as the much-needed green transition. But developments in the financial system can also have disruptive effects on the real economy.

The financial system enables households, businesses, and governments to increase current spending and investments based on future income prospects. It facilitates payments and diversifies risk in safe and efficient markets. Traditionally, banks provide credit, maturity transformation and payment services. Insurance companies offer risk alleviation in exchange for premiums, while pension undertakings manage risk and capital to ensure income security at retirement. Capital markets and their infrastructure connect investors in search of returns with issuers of debt and equity instruments in search of financing. Lastly, there is an increasing array of non-regulated players that are active in equity and debt financing, as well as in payment systems.

However, at times, developments in the financial system are disruptive as financial markets may be unable to absorb and buffer financial shocks, thus amplifying them. When economic setbacks coincide with a financial crisis, their impact is more severe (Reinhart and Rogoff, 2009; Dell'Ariccia *et al.*, 2014; Borio, 2014). The 1929 Great

Depression and the 2007-2008 global financial crisis are prime examples. The destructive effects arise not only from asset losses (Bordo and Haubrich, 2010) but also from the consequences of a halt in financing for the economy (Bernanke, 1983).

Society and the financial system are intrinsically linked. Ensuring that finance serves and protects individuals without triggering financial crises is crucial. When the financial system fails, government interventions are necessary but costly, sometimes risking economic instability. During the global financial crisis, many governments issued guarantees that exceeded their GDP, creating a dangerous link between the fiscal positions of governments and the banks' balance sheets. Access to capital and risk-taking tend to be excessive in good times and too restrictive in bad times (Minsky, 1986; Kiyotaki and Moore, 1997; Brunnermeier and Pedersen, 2009).

There are numerous misalignments between society and the financial system, one being the prevalent informational asymmetry in financial transactions. Financial service providers often possess more knowledge about their products than consumers, raising concerns about trust and the potential emergence of a 'market in lemons' (Akerlof, 1970). Moreover, the specific features of a country have implications for its financial system. For instance, countries with strong creditor protection tend to offer borrowers easier access to credit, while robust shareholder protection benefits the development of capital markets (LaPorta *et al*., 1998; Pagano and Volpin, 2005). Many of these features stem from societal design and political choices. For example, strong creditor protection is more feasible in societies with comprehensive social safety nets that mitigate individual risks (Aghion and Bolton, 1997). Additionally, the political acceptability of foreclosure may increase if local authorities are obligated to provide reasonable housing to those who lose their homes.

Therefore, certain disparities are entrenched in profound political decisions and prove hard to alter. While some may perceive insolvency legislation as antiquated, many legal professionals regard it as second in importance only to constitutions in maintaining stability. Changes to insolvency laws can significantly impact asset values and subsequently affect wealth distribution. For example, more shareholder-friendly legislation may boost shareholder wealth but diminish creditor wealth.

Owing to these factors, the financial sector is subject to more extensive regulation than many other industries, yet achieving optimal regulation poses considerable challenges. Balancing efficiency with robustness involves navigating trade-offs. Establishing a more equitable balance of information between users and providers is imperative, benefiting all parties by fostering fair competition. Nevertheless, determining the most effective approach and extent of regulation remains a complex issue. Despite efforts to provide consumers with comprehensive documentation, many individuals fail to engage with such material, highlighting the need for more accessible material and impactful regulatory measures.

The inherent disparities among EU Member States make it difficult to find optimal solutions. Given the varied contexts, what works best may differ markedly across countries. Some advocate for deeper harmonisation to address such differences, citing attempts to align insolvency and tax laws to foster a more cohesive EU capital market. At the same time, others argue that this approach prioritises the single market over fundamental political autonomy within Member States. This debate underscores the complexity of balancing regional integration with sovereign decision-making.

It is important not to lose sight of the overarching objective concerning the financial system. Ultimately, the aim should be to cultivate a financial system that maximises economic welfare and investment in the sustainable transition. The goal is not merely to build a large financial sector or to ensure the profitability of financial institutions – these outcomes may naturally occur if the financial system effectively supports economic welfare. Instead, the primary focus should remain on fostering a financial system that actively contributes to broader economic prosperity.

Indeed, while a certain scale of financial system undoubtedly enhances economic welfare, after the financial crisis questions arose about the potential drawbacks of excessively large financial systems (Cecchetti and Kharroubi, 2012; Arcand *et al.*, 2015). Large financial institutions, in particular, present dilemmas in terms of resolution and often wield disproportionate lobbying influence. By contrast, smaller, relationship-oriented institutions may have a more crucial impact on civil society (Boot and Thakor, 2000). Furthermore, economic literature indicates that there are limits to economies of scale in banking operations (Hughes and Mester, 1998; Wheelock and Wilson, 2012).

The objective of maximising the contribution of the financial system to economic welfare raises questions about how to achieve it. Governments have traditionally regulated and supervised the financial system to balance benefits and costs, with increased emphasis on regulation following the financial crisis.

For instance, the Basel standards, which serve as international benchmarks for banking regulation, have hugely expanded over the years. Basel I, published in 1988, was a mere 60 pages long, whereas today's Basel standards span nearly 2 000 pages. Similarly, the EU's financial rulebook has grown substantially, comprising over 15 000 pages of regulations, directives, and technical standards. This complexity disproportionately affects smaller institutions, favouring larger ones.

In the EU, all banks, regardless of size, are subject to the same Basel standards, unlike many other jurisdictions where only the largest, internationally active banks are required to comply. While this approach ensures a level playing field, it presents issues for tailoring regulations to smaller banks' needs without sacrificing consistency. Being aware of and properly addressing these challenges is crucial for optimising the financial system's contribution to economic welfare.

Recent problems in the US banking sector, especially among entities not subject to Basel standards, might suggest that the EU's approach of applying Basel standards universally is justified. Even so, this reasoning overlooks the potential for implementing tougher yet simpler regulations suitable for smaller banks, as advocated in the Basel Committee's report on proportionality (BCBS, 2022).

Similarly, non-banking institutions have faced a surge in regulatory complexity and volume, as a result of the intense scrutiny on banks and the rising risks associated with the emergence of new sectors such as crowdfunding and cryptocurrency-related activities, but also new activities. Legislation now addresses a broader array of issues too, including environmental, social and governance (ESG) considerations, as well as operational resilience.

Supervisory oversight has also intensified, with an increasing number of supervisors and supervisory bodies. Examples include the SSM and the Authority for Anti-Money Laundering and Countering the Financing of Terrorism (AMLA). Furthermore, the ESAs, notably European Securities Markets Authority (ESMA), are gradually assuming direct supervisory responsibilities.

Conflicts can arise between objectives related to the single market and those related to financial stability. While single market objectives strive for uniform regulation and supervision, financial stability objectives call for risk-based approaches, which may vary across jurisdictions. This discrepancy becomes particularly pronounced when some jurisdictions have the capacity to implement stricter regulations than others. Countries experiencing rapid economic growth may have greater needs and capabilities to strengthen capital requirements compared with those with stagnant economies.

The financial crisis underscored the necessity of tightening regulation and supervision. Still, in the years following the crisis, European regulations have greatly expanded in scope and complexity. Much of this expansion is justifiable for both financial and broader European integration reasons. There are also instances where regulatory requirements have been diluted to accommodate the financial industry's interests. However, while regulatory expansion may address individual deficiencies, the overall impact of regulatory complexity must be considered. There is a need to reassess the regulatory framework and explore opportunities for simplification without compromising standards. In some cases, simplification may even lead to tighter regulations.

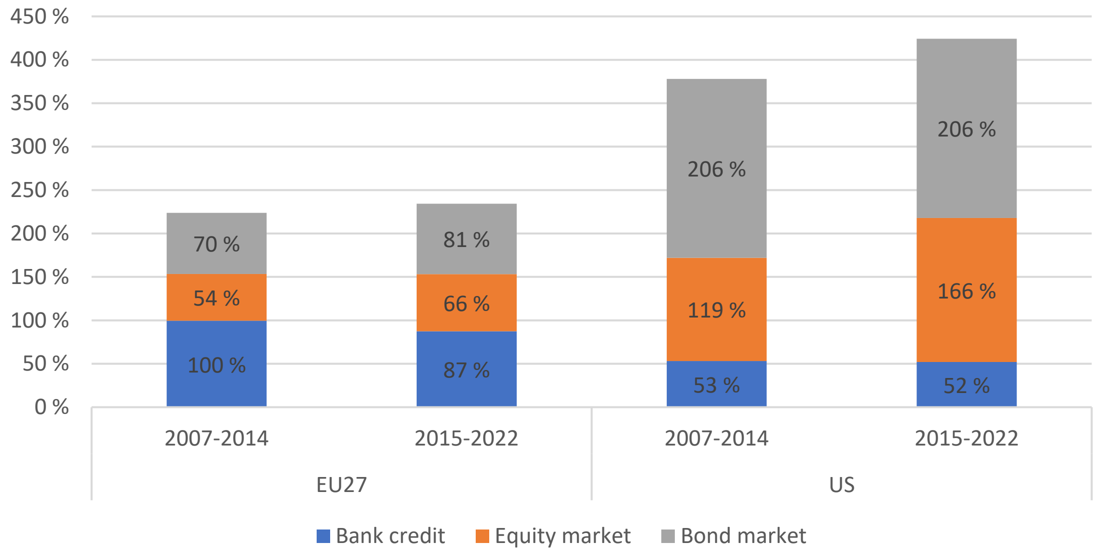
European financial regulation and supervision have made major strides since the financial crisis, enhancing the resilience of the financial system, improving consumer protection, and facilitating access to better and more affordable services for households and businesses. All the same, as we move forward, we must not only ask ourselves what market failures we should be addressing, but also make sure that the costs of the measures we take do not outweigh the benefits.

2. HOW HAVE EUROPE'S FINANCIAL MARKETS DEVELOPED?

- Europe's financial markets have grown in size and complexity, but remain largely bank-centric compared with the more market-oriented US system.
- Regulatory efforts such as the Capital Markets Union (CMU) aim to boost EU capital markets, but progress has been inconsistent and slow, leaving them less developed than US markets in terms of equity, bond and risk capital.
- The EU faces headwinds in achieving full market integration and efficiency, including a fragmented market infrastructure and low levels of financial literacy among its population.
- Recent efforts to strengthen EU capital markets include new legislative proposals and updates to existing regulations, but further action is needed to increase market depth and investor participation.
- European banking has moved from fragmented national markets to greater integration, while financial crises have led to significant regulatory reforms, including the Banking Union and Basel III standards.
- Despite being the largest banking system globally, European banks face lower profitability and market valuations compared with US banks.
- Challenges include uneven regulatory impacts and slow consolidation within the EU. Geopolitical and economic changes, along with incomplete reforms, continue to pose risks to the sector's stability and integration.

Europe's financial markets have developed appreciably in both size and structure over the past two decades. Despite progress in diversifying the financial sector, Europe remains a traditionally bank-centric region, with bank assets constituting a significant portion of GDP (see Figure 1). Although to a lesser extent since the launch of the CMU project in 2015, bank credit markets represent on average about 87 % of GDP, compared with 52 % in the US. The relative importance of market-based financing (i.e. equities and bonds) has grown in Europe from 124 % of GDP in the period 2007-2014 to 147 % of GDP in 2015-2022. Nevertheless, the structural development in Europe contrasts with the more market-oriented financial system of the US, where the equity and bond markets hold a dominant position.

Figure 1. Structure of financial markets in the EU27 and the US (% of GDP, average 2007-2014 and 2015-2022)



Notes: Bank credit refers to the financial resources provided to the private sector by domestic money banks as a share of GDP. Domestic money banks comprise commercial banks and other financial institutions that accept transferable deposits, such as demand deposits. Equity market captures the total value of all listed shares in a stock market as a percentage of GDP. Market capitalisation is shown as at December each year. Bond market refers to the sum of outstanding amounts of corporate and government debt securities, as well as securitisation (European data on securitisation – amounts outstanding – are available from 2007 onwards, while for the US they are available until 2021). End-of-year exchange rates have been used for conversions.
Sources: Authors' calculations based on data from the Association for Financial Markets in Europe (AFME), the Federation of European Securities Exchanges (FESE), the World Federation of Exchanges, the Global Financial Development Database, individual exchanges, FRED Economic Data, and Eurostat.

2.1. CAPITAL MARKETS

2.1.1. *From the Single Market Programme to the Capital Markets Union*

Over the past decades, Europe's capital markets have experienced significant development and transformation, driven by various regulatory initiatives and responses to economic challenges. Starting with the Single Market Programme in 1992, aimed at removing barriers to trade and investment within the EU and fostering greater economic integration, capital markets began to expand, with increasing cross-border activities and investments. In 1999, the ambition of the FSAP was to create a single market for financial services, including directives on market infrastructure, securities, and corporate governance. It consisted of a large series of initiatives taken to ensure the full integration of capital and banking markets by 2005[1].

[1] The objective was to develop the legislative and non-legislative framework along four key areas: (i) a single EU wholesale market, (ii) open and secure retail banking and insurance markets, (iii) the development of state-of-the-art prudential rules and supervision, and (iv) optimal wider conditions (essential fiscal rules) for an optimal single financial market.

However, the dot-com bubble highlighted the need for stronger regulatory frameworks and investor protection, while the global financial crisis of 2007-2008 led to significant reforms to strengthen financial stability and regulatory oversight. In response to that, ESMA was established in 2011 to enhance investor protection and ensure orderly markets. Since then, ESMA has become a central player in EU financial market governance.

More recently, the CMU project, launched in 2015, aimed to further integrate and develop EU capital markets, making it easier for businesses to access funding and for investors to find opportunities across borders. Among its 33 actions were regulatory proposals to relaunch securitisation, promote long-term investment in infrastructure (e.g. through reform of the Solvency II regulatory regime for insurance) and simplify the issuance of prospectuses. There were also public consultations regarding covered bonds and venture capital funds.

The mid-term review of June 2017 updated and supplemented the 2015 action plan, setting out a list of nine priorities. Among these, notable ones included strengthening the powers of ESMA, establishing a regulatory framework to facilitate listings of small and medium-sized enterprises (SMEs), revising the prudential treatment of investment firms and specifying measures to support secondary markets for non-performing loans. Additionally, it was announced that the European Commission would present regulatory proposals on a pan-European personal pension product (PEPP), covered bonds and more legal certainty in the cross-border holding of securities.

Despite significant improvements in the legislative framework for the capital markets, the general sentiment among market participants in 2020 was that much remained to be done to further develop and integrate the EU's capital markets and realise the CMU (Truchet, 2022). There was also a perception that the implementation of CMU measures was progressing too slowly, as they often lacked decisiveness and were frequently subject to diverse national transposition efforts, leading to varying results at the Member State level. This led the Commission to create a High-Level Forum to present proposals for relaunching the CMU. This High-Level Forum proposed a new set of measures in four areas: financing EU companies, market infrastructure, retail investment and the single market. These proposals were incorporated by the Commission at the third CMU action plan, published in September 2020. This action plan contained 16 legislative and non-legislative steps, including the creation of a European single access point to company information for investors.

In November 2021, the European Commission presented four legislative initiatives, namely: (i) the European single access point, (ii) the revision of the European Long-Term Investment Fund (ELTIF) Regulation, (iii) the revision of the Alternative Investment Fund

Managers Directive (AIFMD), and (iv) the revision of the Markets in Financial Instruments Regulation (MiFIR).

A few months later, in March 2022, the Commission published a proposal for a review of the Central Securities Depositories Regulation (CSDR). By the end of the year, three new legislative initiatives were put forward aiming to: (i) enhance the resilience and attractiveness of EU clearing and settlement services (the European Market Infrastructure Regulation, EMIR 3.0), (ii) harmonise certain corporate insolvency rules in the EU (the insolvency law proposal), and (iii) ease the burdens of companies going public (the Listing Act).

An updated list of key indicators to be used for measuring progress in advancing towards the CMU was presented in August 2023. Earlier, in May 2024, the Commission presented a retail investment legislative package, which is made up of an omnibus directive amending the Markets in Financial Instruments Directive (MiFID II), Insurance Distribution Directive, Solvency II, AIFMD and the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive.

Thanks to all these measures, the regulation and supervision of capital markets is much less fragmented than it was back in 2015. This is the case for registration and settlement (CSDR), prospectus issuance (Prospectus Regulation), derivatives and central counterparties (EMIR), and trading and reporting (MiFiR). There is also a single point of settlement in the eurozone (TARGET2-Securities) and progress has been made towards convergence in the supervision of securities markets by granting more powers to ESMA.

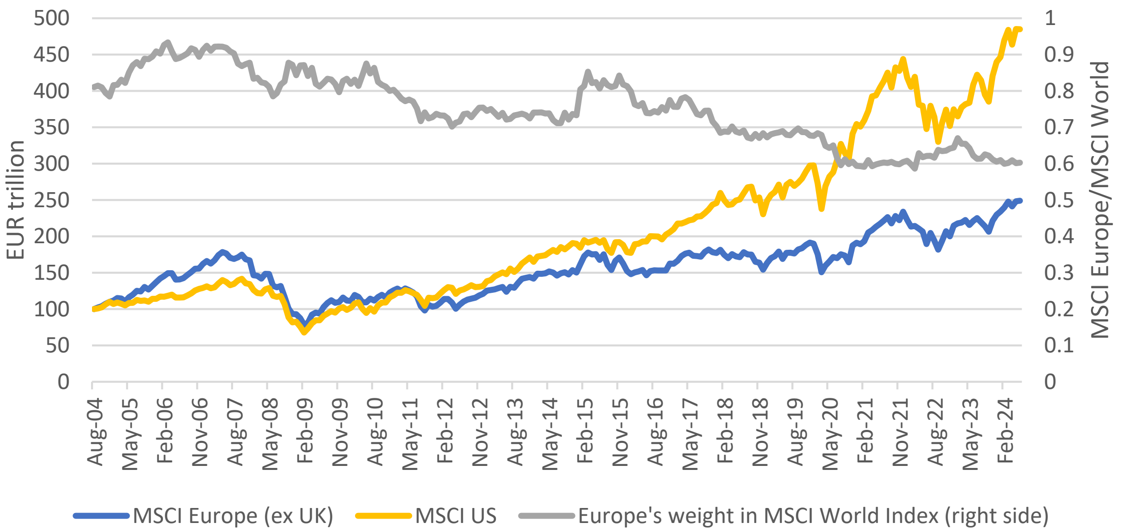
However, the philosophy of the CMU when it was launched back in 2015 mistakenly followed that of the Banking Union. The problem with the EU's capital markets is not so much fragmentation (e.g. companies are free to choose the market in which they want to issue and list bonds and shares), but the lack of development of capital markets (Thomadakis *et al.*, 2022). Indeed, there are several examples today where EU capital markets are more integrated than EU retail banking markets. For instance, investors place their savings in funds investing across the EU, whereas depositors tend to place their savings in domestic bank deposits.

2.1.2. *Still a long way to go*

In spite of all the regulatory and supervisory efforts made at the EU and national levels, Europe's capital markets still face challenges in achieving full integration and efficiency, while their share is diminishing. This is evident when looking at the different indicators and segments of capital markets.

Starting with the equity markets and the MSCI index, while the US has made significant advancements in recent years, Europe's growth has remained stagnant (see Figure 2). Additionally, Europe's share in the MSCI World Index has decreased markedly over the years. This suggests that Europe is losing its competitive edge in global equity markets, with investors increasingly favouring other regions, particularly the United States. The decline in Europe's share of the MSCI World Index reflects not only slower growth in European equity markets but also a potential shift in global investment flows, which could have long-term implications for the region's economic influence and capital market development.

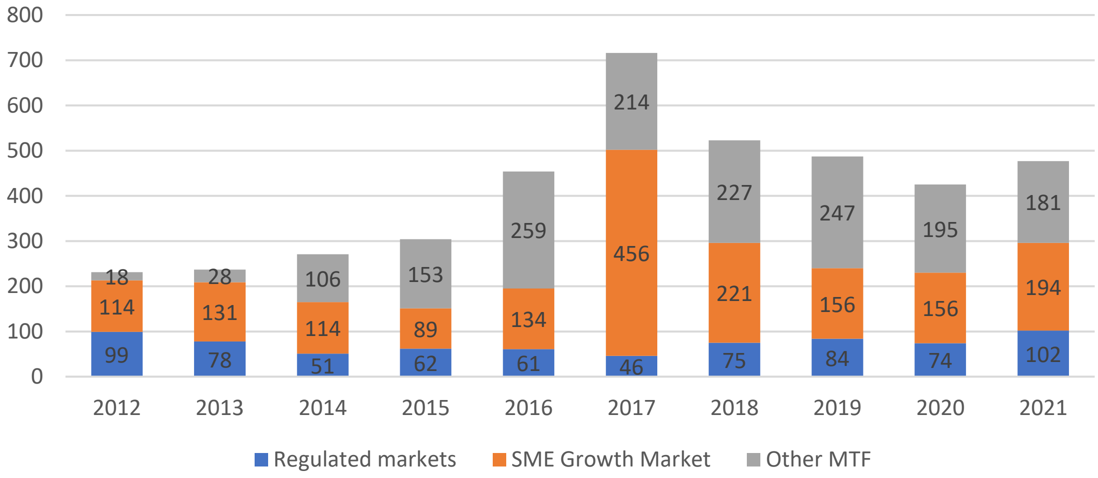
Figure 2. Performance of equity indices in Europe and the US (EUR trillion, 2004-2024)



Notes: The graph plots the price of the MSCI Europe (ex UK) Index, the MSCI USA Index, and Europe's weight in the MSCI World Index for the period August 2004 to June 2024. Europe's weight in the MSCI World Index is the ratio of the MSCI Europe (ex UK) Index to the MSCI World Index. It is a measure of relative performance/strength between the two indexes. A falling ratio suggests that European equity markets are underperforming further relative to the global market. A rising ratio indicates that European equity markets are catching up or performing better relative to the global market. For example, a ratio of 0.5 means that European equity markets are performing at 50 % of the level of the global market. The MSCI Europe (ex UK) Index captures large and mid-cap representation across 14 developed market countries in Europe (i.e. AT, BE, DK, FI, FR, DE, IR, IT, NL, NO, PT, ES, SE and CH) of which 12 are EU Member States. August 2004 prices were set to 100.
Source: Authors' calculations based on MSCI data.

Public listings have dramatically fallen in the EU as a share of global listings, marking a significant decline in the number of companies choosing to go public. Before the inception of the European Single Market, corporates from the EU27 accounted for 5 % of global initial public offerings (IPOs). This figure rose to 20 % following the creation of the single market in the 1990s, but in the last few years has slipped back to around 7 %. The falling share of IPOs is aggravated by the soaring number of delistings, which doubled between 2012 and 2021 (see Figure 3). The main reasons for these delistings are acquisitions, mergers and takeovers.

Figure 3. Number of annual delistings in the EU classified by type of market



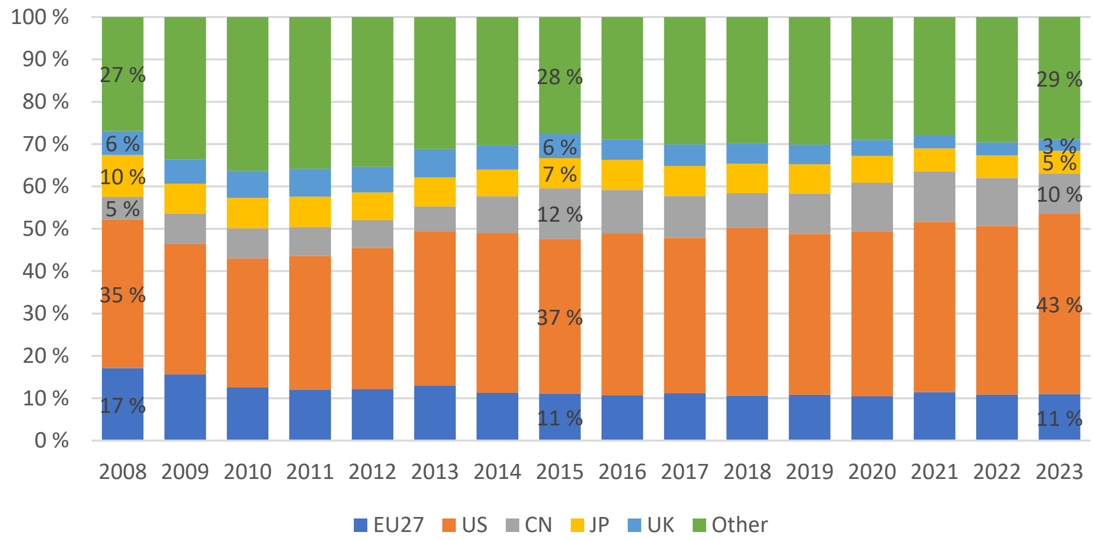
Note: MTF refers to a multilateral trading facility, a trading venue that serves as an alternative to a traditional exchange.
Source: Authors' calculations based on data from the Federation of European Securities Exchanges.

The growing trend in the number of delistings from European exchanges is associated with the increasing number of EU-domiciled companies that are dual-listed in both the EU and the US (ECB, 2024). The reason for deciding to be listed outside the EU is not only the greater market depth and broader investor base that the US market offers, but also the listing requirements. For example, a European company, particularly a large one, may find it easier to qualify for listing on the NYSE on the basis of its market capitalisation (which must be at least USD 750 million), rather than on the LSEG on the basis of the market value of all the securities to be listed (which should be at least GBP 30 million). Moreover, dual-listed companies also take advantage of the foreign private issuer status granted by the US Securities and Exchange Commission, which offers benefits and alleviates some of the compliance costs associated with listing[2].

The lack of development in the EU's capital markets is stark when compared with the US. In 2008, the EU27 accounted for 17 % of the total global market capitalisation, while the US held a 35 % share (see Figure 4). By 2023, the US share had increased significantly to 43 %, whereas the EU's share had declined to 11 %. This decline in Europe's share contrasts with the rise of China's equity markets, which saw its share doubling from 5 % in 2008 to 10 % in 2022.

[2] For example, foreign private issuers can benefit from financial statement flexibility, reporting requirement relief (only semi-annual reporting instead of mandated quarterly reports), flexibility in executive compensation disclosures (as required by their home country), and the option to comply with home-country governance regulations.

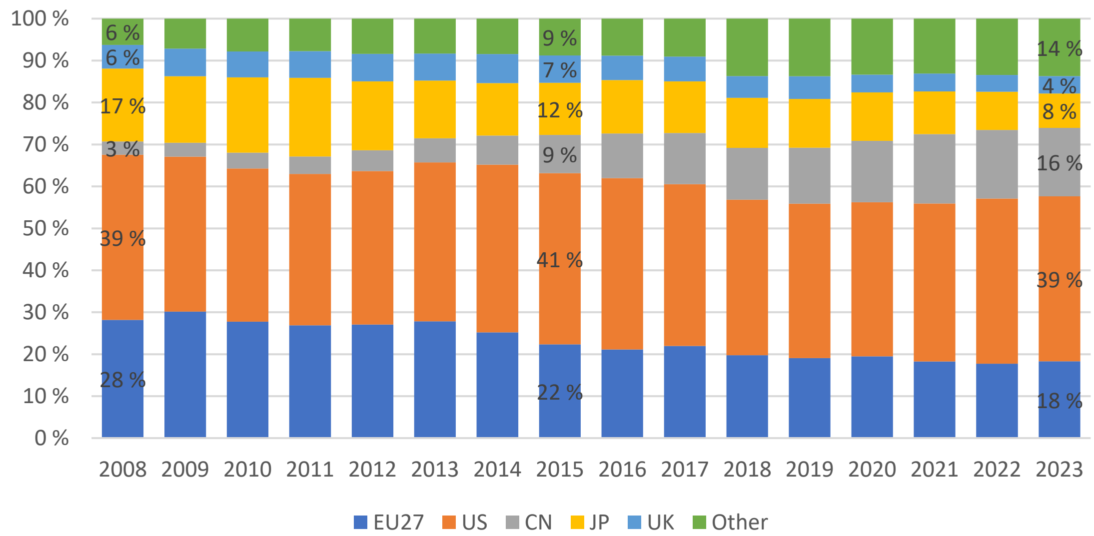
Figure 4. Global equity market capitalisation (share of total, 2008-2023)



Notes: The figure depicts the market capitalisation of listed domestic companies. The category 'Other' includes AU, CA, HK and SG, as well as other developed and emerging markets.
Source: Authors' calculations based on data from the Securities Industry and Financial Markets Association.

This trend is also evident in fixed income markets (see Figure 5). The US has maintained a stable global market share of about 40 %, whereas Europe's share has shrunk from 28 % in 2008 to 18 % in 2023. More importantly, the EU is also losing ground to China, whose share of global fixed income markets grew from 3 % to 16 % over the same period.

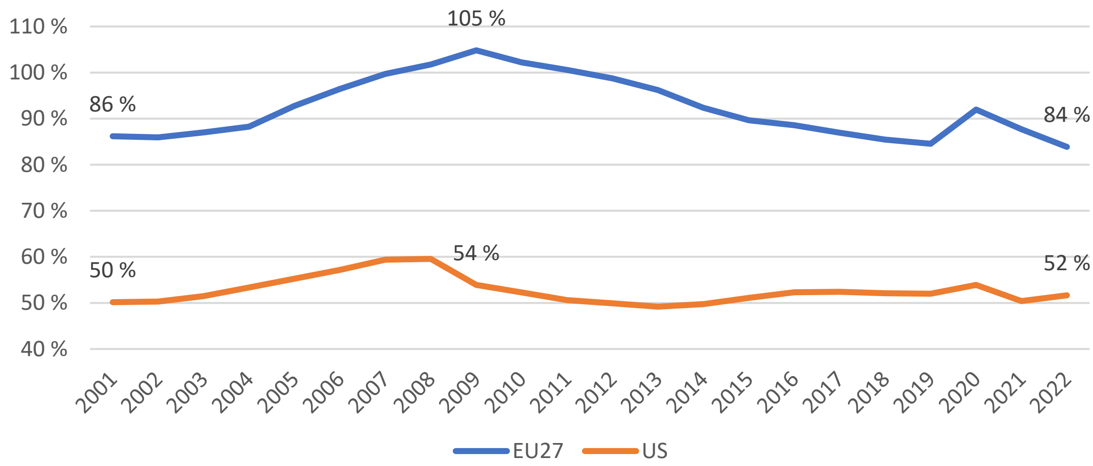
Figure 5. Global fixed income market outstanding (share of total, 2008-2023)



Note: The category 'Other' includes AU, CA, HK and SG, as well as other developed and emerging markets.
Source: Authors' calculations based on data from the Bank for International Settlements.

The insufficient development of capital markets in the EU has significant consequences for business funding. In the bank-based European market, the amount of bank credit to the private sector is about 30 percentage points higher (84 % of GDP in 2022) than in the US (52 % of GDP in 2022) (see Figure 6). Although this, by itself, is not a problem, when combined with the low volume of market-based financing, it might reflect reduced financial diversification opportunities for companies, which could in turn make it harder to absorb macroeconomic shocks.

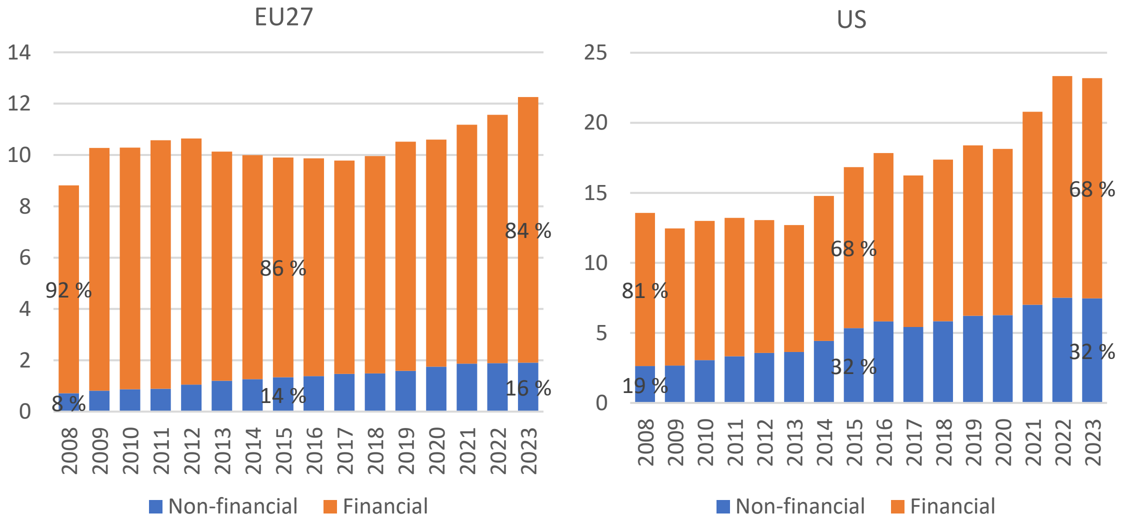
Figure 6. Domestic credit to the private sector by banks (% GDP, 2001-2022)



Notes: Domestic credit to the private sector by banks refers to financial resources provided to the private sector by other depository corporations (deposit taking corporations except central banks), such as through loans, purchases of nonequity securities, trade credits and other accounts receivable, which establish a claim for repayment.
Source: Authors' calculations based on data from the World Bank.

In the case of bond markets, the total size of the EU market, including sovereign and corporate debt, increased by 65 % from 2008 (EUR 14.6 trillion) to 2023 (EUR 24 trillion or 144 % of GDP). This compares with a bond market size of EUR 50 trillion (or 197 % of GDP) in the US in 2023, up by 150 % since 2008. Zooming in on the corporate debt segment, the size of the market in the EU grew from around EUR 9 trillion to EUR 12 trillion between 2008 and 2023, of which 16 % was the outstanding debt of non-financial sector firms (see Figure 7 left-hand panel). In the US, the share of debt of non-financial corporations was double, 32 % (see Figure 7 right-hand panel).

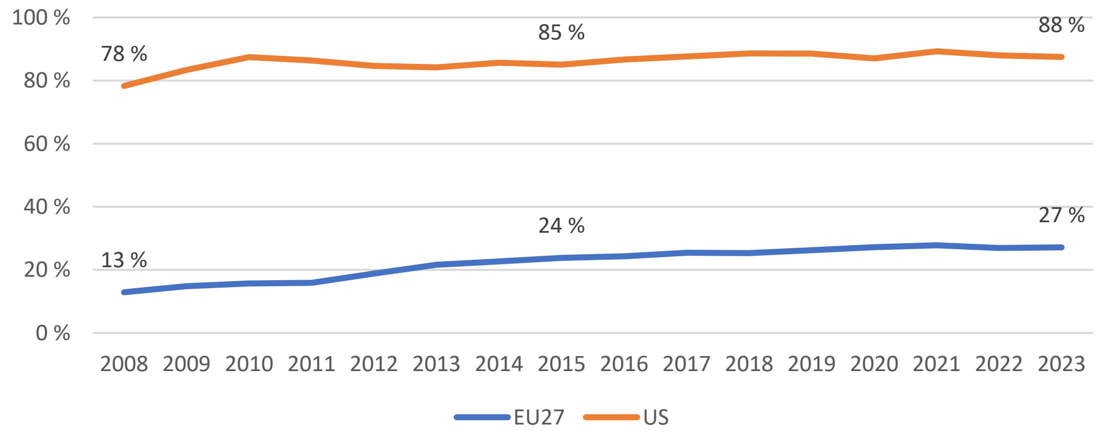
Figure 7. Corporate bond markets in the EU27 and the US (EUR trillion, 2008-2023)



Notes: The figure depicts the notional amount outstanding of debt securities issued by non-financial and financial corporations. Romania has been excluded due to lack of data.
Sources: Authors' calculations based on data from the Bank of International Settlements and Eurostat.

From a structural perspective, the US and EU markets are different. EU non-financial corporations rely on loans for their funding needs to a greater extent than their US counterparts (see Figure 8). From 2008 to 2023, on average, the size of the notional amount outstanding of bonds issued by EU non-financial corporations represented 22 % of total non-financial corporate debt (i.e. the sum of outstanding bonds and loans), meaning that 78 % of corporate debt was bank financing. In the US, by contrast, 86 % was raised through the capital markets.

Figure 8. Financing structure of non-financial corporations in the EU27 and the US (2008-2023)

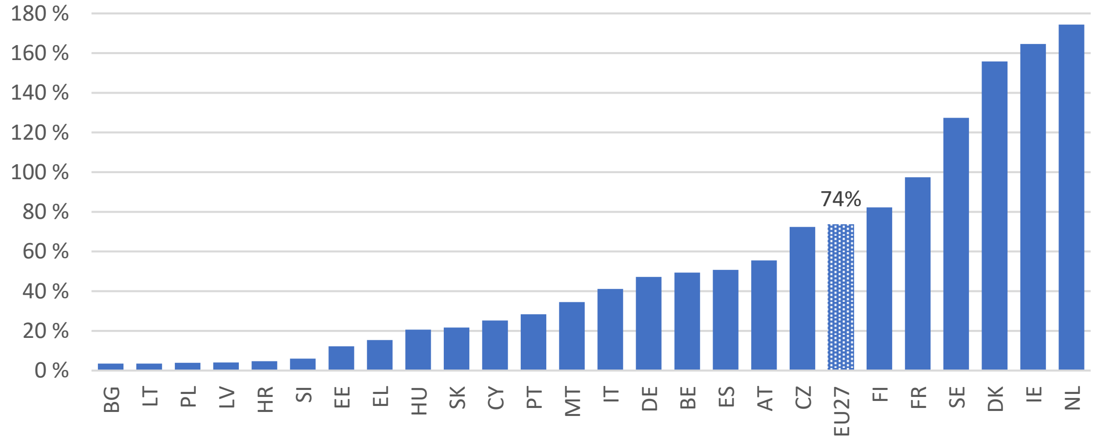


Notes: The figure depicts the bonds outstanding of non-financial corporations as a % of total non-financial corporate debt (i.e. bonds and loans). Loan data for the EU27 refer to loans vis-a-vis euro area non-financial corporations reported by monetary financial institutions (excluding the European System of Central Banks) in the euro area. Loan data for the US refer to non-financial corporate business loans.
Sources: Authors' calculations based on data from the Bank for International Settlements, European Central Bank, FRED Economic Data and Eurostat.

The heavy reliance on bank financing places a natural limit on the amount of debt financing needed by EU companies. At the same time, it makes the EU economy far more vulnerable to banking crises and less resilient to financial shocks (as banks' capacity to lend becomes constrained), and reduces the amount and diversity of investible EU financial assets.

Across Member States, it has become evident that market-based EU countries (e.g. DK, FI, FR, IE, NL and SE) have on average a much bigger market for corporate bonds relative to the size of their economy than bank-based countries (e.g. AT, DE, ES and IT) (see Figure 9).

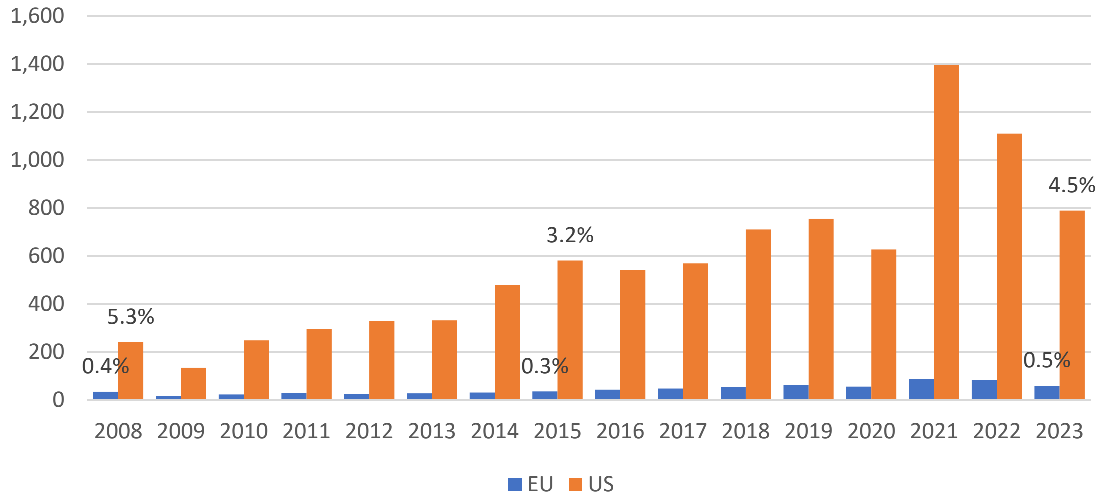
Figure 9. Size of the corporate bond markets across Member States (% of GDP, 2023)



Notes: The figure depicts the notional amount outstanding of debt securities issued by non-financial and financial corporations. Romania has been excluded due to lack of data. Luxembourg's size, not shown in the figure, is 1 048 %.
Sources: Authors' calculations based on data from the Bank of International Settlements and Eurostat.

Risk capital investments are low in the EU, which impedes the development of start-ups and scale-ups (see Figure 10). Risk capital is particularly relevant for early-stage companies that do not yet have a sufficient track record to access more traditional financing sources, such as banking. In 2023, venture capital investment in the EU27 represented 0.1 % of GDP (EUR 8.4 billion), six times lower than that in the US (0.6 % of GDP or EUR 150 billion), while private equity investment stood at 0.3 % of GDP (EUR 50.7 billion) compared with 2.5 % of GDP in the US (EUR 639 billion).

Figure 10. Pre-IPO risk capital investments in the EU27 and the US (EUR billion and % of GDP, 2008-2023)



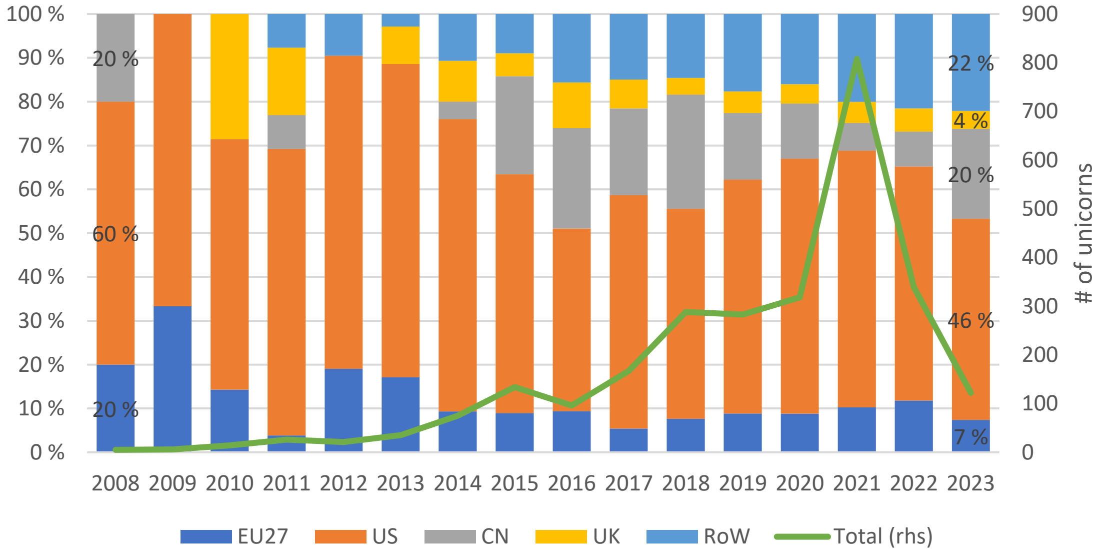
Notes: Total pre-IPO risk capital refers to the sum of equity crowdfunding, business angel, venture capital (VC) and private equity (PE) investments. Data on equity crowdfunding are available from 2014 to 2022 for the EU27 and from 2016 to 2023 for the US. Data on European business angel investment are available from 2011 to 2022. Data on European VC and PE investments refer to industry statistics (i.e. location of the PE/VC firm). European VC stages include seed, start-up and later-stage venture. European PE stages include growth capital, turnaround/rescue, replacement capital and buyout. US VC stages include angel & seed, early VC and later VC. US PE stages include PE growth/expansion, add-on and buyout/leveraged buyout. The amounts invested by European and US VC companies are not directly comparable. This is because the PitchBook reports data that capture the entire investment round of VC-backed companies. In many cases, this may include other types of investors (other than formal PE/VC funds) that participate in such rounds. By contrast, Invest Europe reports data that are focused on formal PE/VC funds and their equity investments. Data for VC and PE for the EU27 do not include Cyprus and Malta.
Sources: Authors' calculations based on data from the Cambridge Centre for Alternative Finance, Center for Venture Research – University of New Hampshire, European Business Angels Network, Eurostat, Florida Atlantic University – College of Business, FRED Economic Data, Invest Europe and PitchBook.

When diving deeper into the different stages of the funding escalator, the two markets are of comparable size with regard to the early stages (i.e. business angel, equity crowdfunding and early-stage venture capital). But the gap increases noticeably as we move along the funding escalator and towards later-stage venture capital and private equity. Indeed, there are at least seven times more venture capital funds of a large size (more than EUR 600 million) in the US than in the EU, while more than 50 % of EU late-stage tech financing rounds comes from outside the EU.

This limited investment in risk capital is one of the reasons why the presence of unicorns[3] is very low in the EU (see Figure 11). About 66 % of the 122 unicorns established in 2023 were based in the US and China, and only 7 % (or 9 unicorns) were European. Within Europe, activity is concentrated in four Member States (i.e. DE, FR, NL and SE), which collectively accounted for 65 % of all unicorns between 2008 and 2023.

[3] Technology or innovation-based companies that begin as startups and eventually reach valuations exceeding EUR 1 billion.

Figure 11. Location of unicorns (share of the global number of unicorns, 2008-2023)

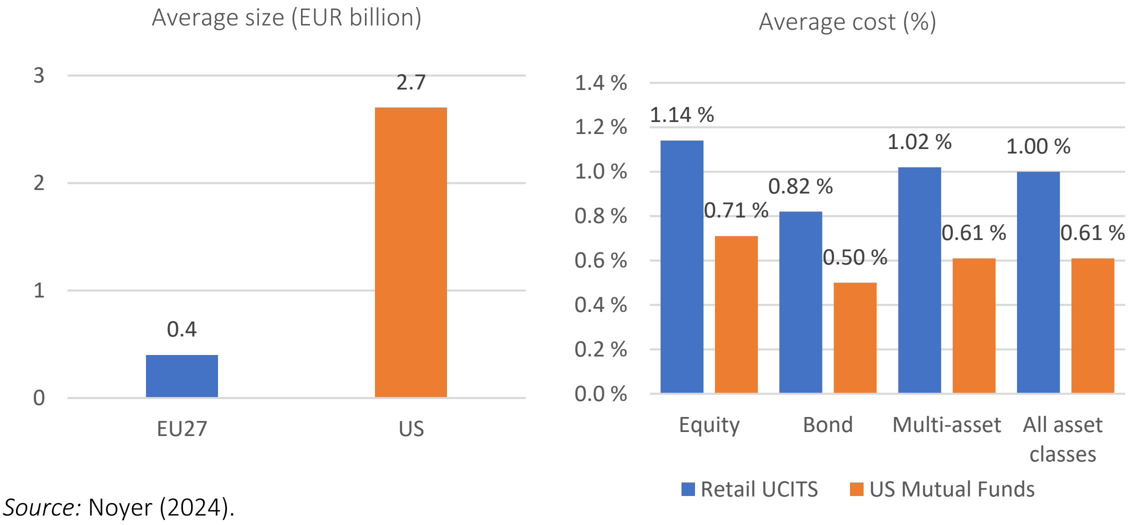


Notes: Based on the cumulative number of unicorns in the period 2008-2023. The figure includes unicorns headquartered in or originally founded in each respective country.
Source: Authors' calculations based on data from Dealroom.co.

Moreover, this suggests that when start-ups become scale-ups, many of them leave as funding is not available in the EU. There are several examples of EU scale-ups now headquartered in the US due to funding availability: the Romanian UIPath, the French Aircall, the Belgian Collibra and the Greek Blueground. This highlights the need to support later-stage funding for start-ups and scale-ups, which should come hand in hand with public support to catalyse private funding. In this regard, the first steps of the European Tech Champions Initiative managed by the European Investment Fund should be closely analysed, introducing amendments if needed and further increasing its budget if it works properly.

Moving on to investment funds, the average size of an EU fund is less than a sixth of a US fund (see Figure 12 left-hand panel). Furthermore, the average cost of a European investment fund is about 0.4 percentage points higher than the cost of a US fund (ESMA, 2023c; Morningstar 2024) (see Figure 12 right-hand panel).

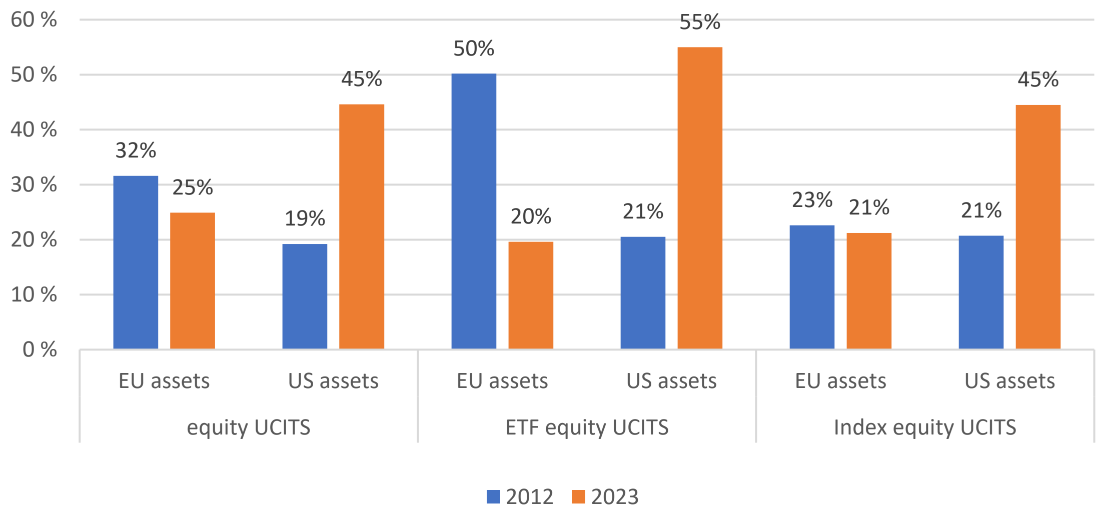
Figure 12. Average size (EUR billion) and average cost (%) of an investment fund in the EU and the US



Source: Noyer (2024).

On top of that, the asset allocation of European funds is heavily tilted towards US assets (see Figure 13). From 2012 to 2023, the portfolio of equity UCITS decreased its allocation in European assets by 7 percentage points, while it increased its investment in US assets (from 19 % to 45 %). This is even more evident in exchange-traded fund equity UCITS, illustrating the growing investor appetite for higher returns and greater liquidity. Interestingly, this trend is correlated with the huge increase in the EU market share of US asset managers, which reached 40 % in 2023 (Noyer, 2024).

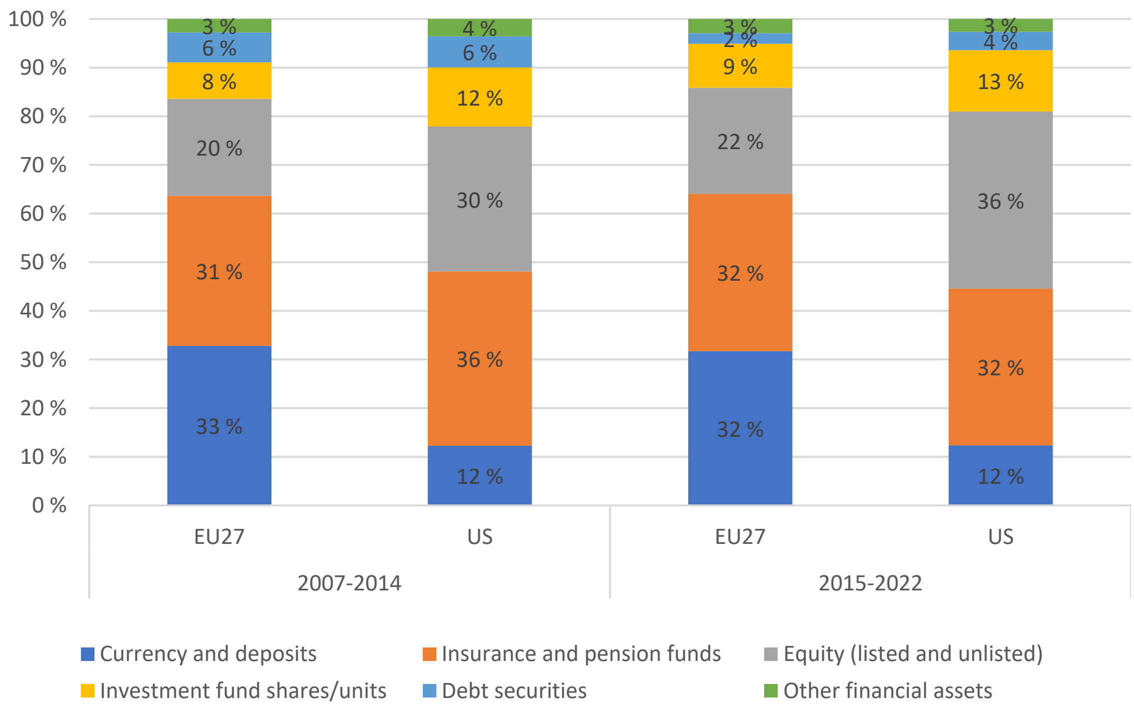
Figure 13. Share of assets in different types of equity UCITS (2012 and 2023)



Source: Authors' calculations based on data from the European Fund and Asset Management Association (EFAMA, 2024).

One of the reasons why EU capital markets remain significantly smaller (relative to the size of the economy) than the corresponding US markets may be the way financial assets are allocated. Although the asset allocation of European households has tilted more towards capital markets since the inception of the CMU project, investment in capital markets is much lower than that in the US (see Figure 14). On average, European households hold about 32 % of their financial assets in cash and deposits, compared with 12 % for US households, who instead invest nearly 50 % of their savings in equity and investment funds, compared with about 30 % for their European counterparts. This different allocation of household financial assets can help explain, at least partially, why capital markets in the EU are less developed than in the US, thereby reducing alternative sources of financing for the European private sector.

Figure 14. Household financial assets in the EU27 and the US (% of total financial assets, on average in 2007-2014 and 2015-2022)

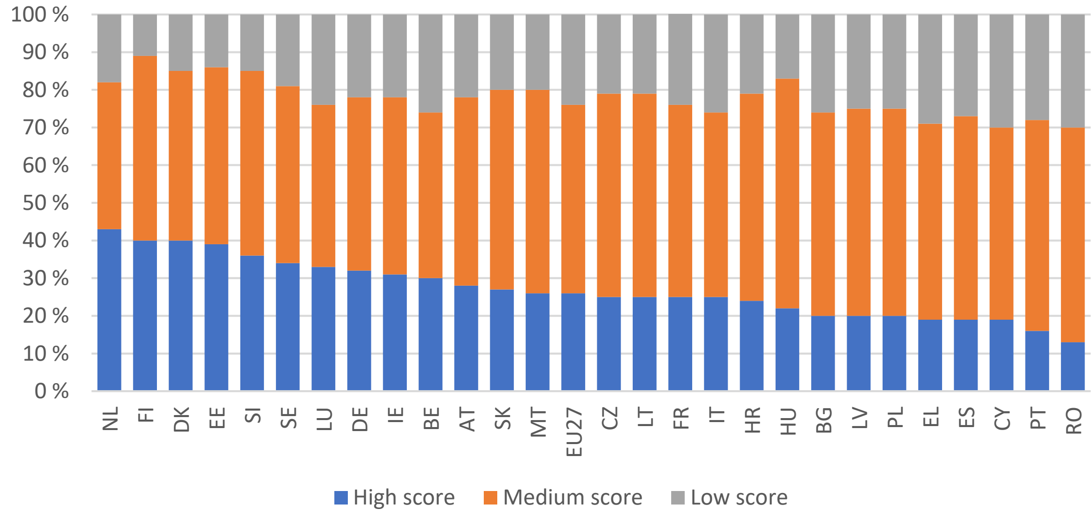


Notes: The category 'Other financial assets', for the EU includes other accounts receivable, financial derivatives and loans. For the US it includes other miscellaneous assets and loans.
Sources: Authors' calculations based on data from Eurostat and FRED Economic Data.

In addition to a potential lack of suitable measures to channel the EU's savings into mutual and pension funds (for instance, through a pre-paid pension system), the preference of European households for cash and deposits, i.e. keeping their assets in a simpler and presumably safer manner, may be related to insufficient financial education. Greater financial literacy could encourage investment in a broader range of financial products and, consequently, the development of capital markets.

Until June 2023, there were no statistics comparing levels of financial education in different EU countries (a symptom of the little importance given to the issue so far and the purely national focus). The first Eurobarometer survey on financial education, published in June 2023, revealed low levels of financial literacy across the EU (see Figure 15). Based on five questions that tested respondents' broad financial knowledge (i.e. in relation to inflation, compound interest, the risk-return relationship, investment diversification and the relationship between bond prices and interest rates), the results show that 26 % of the EU public has a high level of financial literacy and 50 % has a medium level, while the remaining 24 % have a low level.

Figure 15. Financial knowledge across Member States (% of correct answers by Member State, 2023)



Notes: The figure shows the financial knowledge score based on the number of correct responses to five financial knowledge questions. A high score means that the respondent had four or five correct answers. A medium score means that the respondent had two or three correct answers. A low score means that the respondent had no or one correct answer.
Source: Authors' calculations based on data from the European Commission.

What is more, the Eurobarometer indicated that only 38 % of respondents in the EU trust the financial advice given by their bank, insurer or financial advisor. This situation calls for a boost of public efforts to increase financial literacy levels and to design financial instruments that will facilitate long-term investments while ensuring a high level of consumer protection.

Another distinctive element of EU capital markets is the fragmentation of market infrastructure. Across the 27 Member States, there are 27 different national stock exchanges (excluding smaller regional or specialised exchanges such as those in Germany and Spain), while in the US there are only two major exchanges (i.e. the Nasdaq and NYSE). The 27 exchanges are organised into 15 exchange groups (see Table 1), with the consolidation primarily being driven by Euronext and Nasdaq. Still, while the exchange operating companies have merged, the actual markets in which they operate have not. The exchanges continue to have separate licences per country and supervision remains at the national level. For groups, supervisors work in colleges, meaning that for a group like Euronext, there is a college composed of 7 supervisors (EU and EEA), even though it concerns one business entity. For Nasdaq, it involves 6 EU supervisors, with the US Securities and Exchange Commission as the home country authority.

Table 1. List of stock exchanges and exchange groups across the EU (as of end-2023)

Country	Stock exchange	Exchange group
AT – Austria	Vienna Stock Exchange	Wiener Börse
CZ – Czechia	Prague Stock Exchange	
BE – Belgium	Euronext Brussels	Euronext
FR – France	Euronext Paris	
IR – Ireland	Euronext Dublin	
IT – Italy	Borsa Italiana	
NL – Netherlands	Euronext Amsterdam	
PT – Portugal	Euronext Lisbon	
BG – Bulgaria	Bulgarian Stock Exchange	Bulgarian Stock Exchange
CY – Cyprus	Cyprus Stock Exchange	Cyprus Stock Exchange
DE – Germany	Deutsche Börse	Deutsche Börse
DK – Denmark	Nasdaq Copenhagen	Nasdaq
EE – Estonia	Nasdaq Tallinn	
FI – Finland	Nasdaq Helsinki	
LT – Lithuania	Nasdaq Vilnius	
LV – Latvia	Nasdaq Riga	
SE – Sweden	Nasdaq Stockholm	
EL – Greece	Athens Stock Exchange	Athens Stock Exchange
ES – Spain	BME	SIX Group
HR – Croatia	Zagreb Stock Exchange	Zagreb Stock Exchange
SI – Slovenia	Ljubljana Stock Exchange	
HU – Hungary	Budapest Stock Exchange	Budapest Stock Exchange
LU – Luxembourg	Luxembourg Stock Exchange	Luxembourg Stock Exchange
MT – Malta	Malta Stock Exchange	Malta Stock Exchange
PL – Poland	Warsaw Stock Exchange	Warsaw Stock Exchange
RO – Romania	Bucharest Stock Exchange	Bucharest Stock Exchange
SK – Slovakia	Bratislava Stock Exchange	Bratislava Stock Exchange

Source: Authors' elaboration.

Regarding trading infrastructure, and according to the latest data, the EU hosts 116 regulated markets, 149 multilateral trading facilities, 30 organised trading facilities and 180 systematic internalisers. While the number of trading facilities is significant, the main difference compared with the US lies in the post-trading infrastructure and chiefly with central securities depositories (CSDs), but also with other intermediaries, such as custodians. In the US, there are only two CSDs (the Depository Trust Company and the

Federal Reserve's Fedwire Securities Service), while in the EU there are 24 CSDs and 2 international CSDs (ICSDs) operating across 27 Member States (see Table 2).

Table 2. List of authorised central securities depositories across the EU (as of June 2023)

Country	Name of CSD	CSD Group
AT – Austria	OeKB CSD	Wiener Börse
CZ – Czechia	CSD Prague	
BE – Belgium	Euroclear Bank ICSD	Euroclear
BE – Belgium	CIK (Euroclear Belgium)	
FI – Finland	Euroclear Finland	
FR – France	Euroclear France	
IE – Ireland	Euroclear Bank	
NL – Netherlands	Euroclear Nederland	
SE – Sweden	Euroclear Sweden AB	
BG – Bulgaria	Central Securities Depository	Bulgarian CSD
CY – Cyprus	Central Depository Central Registry	Cyprus Stock Exchange
DE – Germany	Clearstream Banking AG	Deutsche Börse
LU – Luxembourg	Clearstream Banking S.A. ICSD	
LU – Luxembourg	LuxCSD	
DK – Denmark	VP Securities A/S	Euronext
IT – Italy	Monte Titoli	
PT – Portugal	Interbolsa	
EE – Estonia	Nasdaq CSD SE (Estonia branch)	Nasdaq
LT – Latvia	Nasdaq CSD SE (Latvian branch)	
LV – Lithuania	Nasdaq CSD SE (Lithuanian branch)	
EL – Greece	ATHEXCSD	Athens Stock Exchange
ES – Spain	IBERCLEAR	SIX Group
HR – Croatia	SKDD/CDCC	Zagreb Stock Exchange
SI – Slovenia	KDD	
HU – Hungary	KELER	Budapest Stock Exchange
MT – Malta	Malta Stock Exchange	Malta Stock Exchange
PL – Poland	KDPW	KDPW
RO – Romania	CD Romania	Bucharest Stock Exchange
SK – Slovakia	CDCP	Bratislava Stock Exchange

Note: The CSDs listed here have been authorised by ESMA in accordance with the CSDR. As of March 2021, Ireland's CSD migrated to Euroclear Bank. Other national CSDs are not included in this list. For example, a second CSD in Greece – the Bank of Greece Securities Settlement System – is managed and run by the Bank of Greece. As it is a central-bank owned CSD, it is not authorised by ESMA and hence does not appear on this list.

Source: Authors' elaboration based on data from ESMA.

Although this may have the advantage that the CSD ecosystem can sufficiently support local or regional market development, CSD interoperability is far from perfect (also due to the EU's underlying legal and jurisdictional fragmentation), hence hindering the cross-border operation of CSDs and consolidation[4]. Moreover, a recent report found a lack of structured cooperation between home and host authorities in the supervision of CSDs, with only one fully-fledged college of supervisors in existence (ESMA 2023a). The CSDR Refit legislation, agreed in 2023, requires the establishment of a college of supervisors for CSDs undertaking activities considered to be of substantial importance in at least two host Member States.

The CCP (central counterparty clearing house) landscape is less fragmented in Europe compared with the CSD market (see Table 3), as central clearing tends to be concentrated in a few large financial centres. But here too, the supervisory structure is not suitably adapted, with large colleges of supervisors for a few CCPs – indeed more supervisors than supervised entities. LCH SA, for example, the largest CCP in Europe, has 22 different authorities on its college (ESMA, 2024b). This highlights the necessity for supervisory authorities to reconsider how they can best fulfil their mandates through enhanced cross-border cooperation.

Table 3. List of authorised central counterparty clearing houses across the EU (as of July 2024)

Country	Name of CCP
AT – Austria	CCP Austria Abwicklungsstelle für Börsengeschäfte GmbH (CCP.A)
DE – Germany	Eurex Clearing AG European Commodity Clearing
EL – Greece	Athens Exchange Clearing House (Athex Clear)
ES – Spain	BME Clearing
FR – France	LCH SA
HR – Croatia	SKDD-CCP Smart Clear
HU – Hungary	Keler CCP
IT – Italy	Cassa di Compensazione e Garanzia S.p.A (CCG-Euronext
NL – Netherlands	Cboe Clear Europe N.V. ICE Clear Netherlands B.V.
PL – Poland	KDPW_CCP
PT – Portugal	OMIClear – C.C., S.A.
SE – Sweden	Nasdaq OMX Clearing AB

Note: The CCPs listed here have been authorised to offer services and activities in the EU in accordance with Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR).
Source: Authors' elaboration based on data from ESMA.

[4] The Eurosystem's TARGET2-Securities project has provided a common infrastructure for CSDs to facilitate the cross-border transfer of cash and securities. However, T2S has not (yet) reached its objective of reducing the cost of settlement in the EU27, or of further integrating back offices in Europe (Thomadakis *et al.*, 2022). Nevertheless, it has acted as an important driver for alignment among local and regional markets.

2.2. BANKING

2.2.1. *Various forms of harmonisation*

The European banking sector has undergone significant transformation over the past decades. The Treaty of Rome of 1957 aimed to change the system of highly segmented national markets into a single common market. In 1973, a Directive abolished restrictions on the freedom of establishment and provision of services by banks and other financial institutions. It tried to apply the national treatment principle to ensure equal regulatory and supervisory treatment of all firms operating in a country. Yet, as the supply of cross-border services was restricted and there was little coordination of banking supervision, banks operating in different countries were subject to different rules. This led to efforts to better harmonise banking regulations.

Although adoption of the First Banking Directive in 1977 established the principle of home country control, it failed to provide any specific regulation or integrate the European banking markets[5]. The European Commission's 1985 White Paper on Completing the Internal Market called for a single banking licence, home country control and mutual recognition. Yet it was the Second Banking Directive of 1989 that allowed credit institutions authorised in one EU country to establish branches or offer cross-border financial services in other EU countries without needing additional authorisation, as long as the bank is authorised to provide those services in its home state. Coupled with the 1988 Directive on the liberalisation of capital flows the 1994 Directive on Deposit Guarantee Schemes, and the 1992 Treaty of Maastricht, the stage was set for a more integrated and regulated European banking sector[6].

The introduction of the euro in 1999 facilitated greater financial integration and cross-border banking activities within the eurozone, as banks could operate more easily across national borders, benefiting from the elimination of currency risk within the eurozone. The sector grew substantially in the early 2000s, as banks expanded their balance sheets and increased cross-border lending and investment activities, while a wave of mergers and acquisitions led to the formation of large, multinational banking groups seeking to leverage economies of scale.

---

[5] While the majority of international agreements have relied on the national treatment principle, ensuring equal treatment for all companies operating within a country, the European Commission employed a robust integration approach known as home country control. This means that the responsibility for the supervision of credit institutions operating in two or more member countries shifts from the host to the home country of the parent bank. However, this approach was characterised by minimal harmonisation of national regulations.

[6] Nevertheless, the fact that the capital flows directive of 1988 contained a safeguard clause empowering Member States to take necessary measures in the event of balance-of-payments problems prevented the complete and permanent freedom of capital flows, due to uncertainty.

The 2008 global financial crisis severely impacted European banks, exposing weaknesses in risk management, particularly in relation to subprime mortgages and other complex financial products. The eurozone sovereign debt crisis (2010-2012) further stressed the banking sector, as banks held substantial amounts of government debt. They faced major challenges in maintaining sufficient capital and liquidity, leading to numerous bailouts and interventions by national governments and the European Central Bank (ECB).

In response to the crises, the EU implemented comprehensive regulatory reforms aimed at strengthening the banking sector. Steps in the creation of the Banking Union comprised: (i) the SSM and the Single Resolution Mechanism (SRM), (ii) the introduction of Basel III standards, leading to higher capital and liquidity requirements, (iii) the performance of stress tests by the ECB and the European Banking Authority (EBA)[7], assessing the health of banks and ensuring they could withstand economic shocks, and (iv) the Bank Recovery and Resolution Directive (BRRD), establishing a framework for the orderly resolution of failing banks.

All of these steps contributed to improving the resilience of European banks. Covid-19 was a big test for the banking sector, but due to strengthened capital positions and the ECB's request that banks refrain from dividends, along with the previously introduced regulatory measures, banks played a crucial role in supporting the economy through loan moratoria and government-backed lending programmes. The March 2023 financial turbulence – with the collapse of Silicon Valley Bank and Credit Suisse (Thomadakis 2023a and 2023b) – is another example illustrating that the European banking sector can withstand major systemic risks affecting other jurisdictions (Thomadakis and Arnal, 2024).

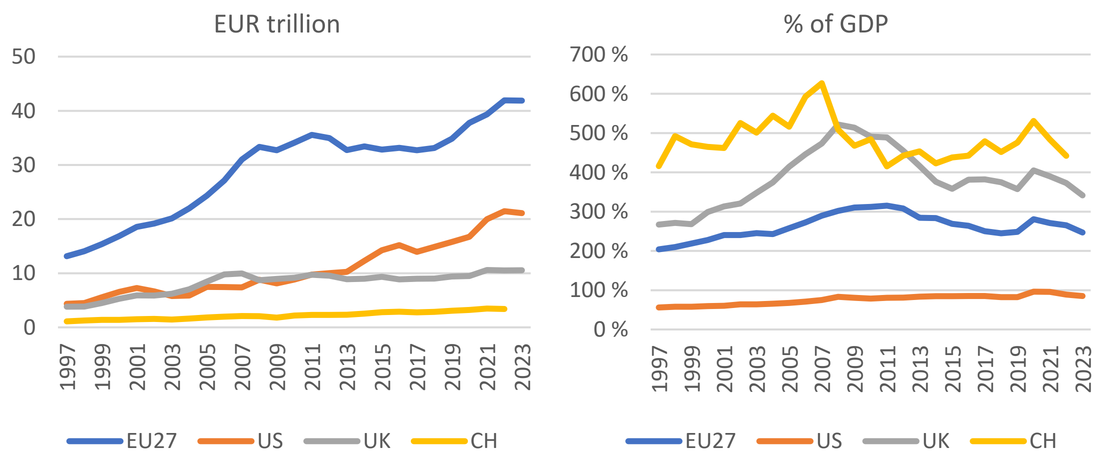
However, geopolitical tensions, a rapidly changing economic landscape, and the twin transition that the EU wants to achieve entail significant implications for banks. Also, relevant pieces for completing the Banking Union are still missing: the entry into force of the common backstop to the Single Resolution Fund (Arnal, 2023b), a mechanism for liquidity provision in resolution beyond the Fund and the common backstop and the adoption of the European deposit insurance scheme, with the European Commission's 2015 legislative proposal still languishing on Member States' desks. Nonetheless, all the possible technical work has already been done on these two files, with the next steps solely blocked at the political level. This calls for avoiding fruitless political discussions and focusing work on the areas where technical and political progress can be made.

[7] The first stress test on the European banking sector was conducted in 2009. This was initiated by the Committee of European Banking Supervisors, the predecessor of the EBA, in response to the global financial crisis that had started in 2007-2008.

2.2.2. *Well capitalised banks but lack of revenue, scale, low returns and valuation*

Today, Europe is home to the world's largest banking system, although it has not always been that way. In fact, from the 1880s until the 1960s, bank assets to GDP fluctuated at around 70 % in major western European countries and the US. By the 1980s, bank assets had more than doubled to about 180 % of GDP in some European countries (Hardie and Howarth, 2013; Pagano *et al.*, 2014). Only since 1990 has Europe's banking system grown so much larger than its international peers (Langfield and Pagano, 2015). The total assets of banks in the EU27 amounted to about EUR 41.9 trillion in 2023, corresponding to 247 % of EU27 GDP (see Figure 16). By contrast, US bank assets were worth EUR 21.2 trillion (85 % of US GDP). Although the total assets of Swiss banks were EUR 3.6 trillion at the end of 2022, relative to the size of the economy they represented about 442 % of Swiss GDP.

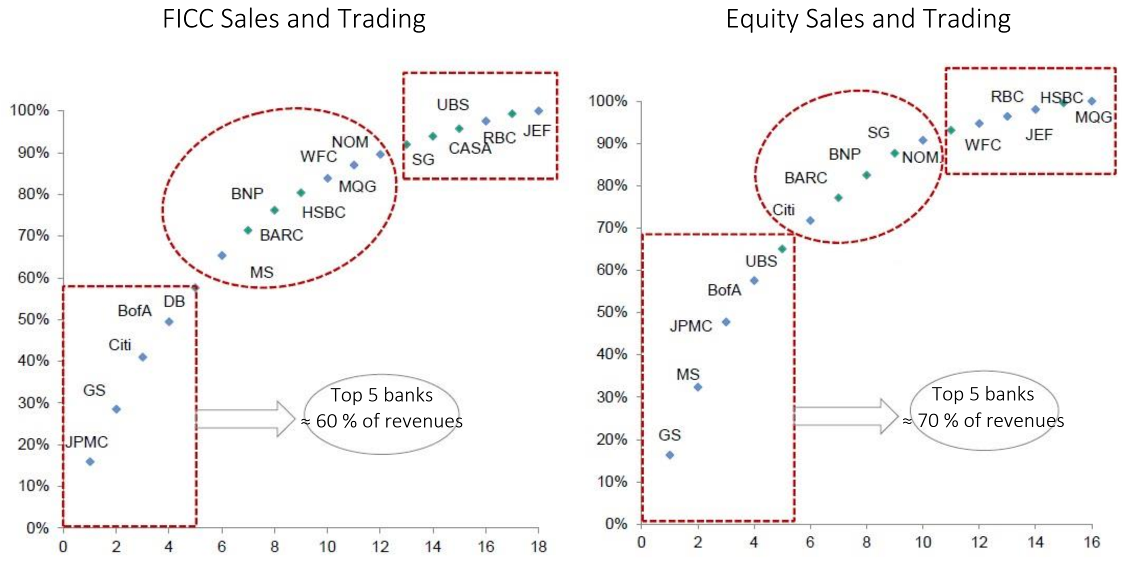
Figure 16. Total assets of credit institutions (EUR trillion and % of GDP, 1997-2023)



Notes: The inclusion of countries in the EU27 follows the different waves of EU enlargement. From 1998 to 2003, the following countries were included in the sample: AU, BE, DE, DK, EL, ES, FI, FR, IE, IT, LU, NL, PT and SE. After 2004, the following countries were added: CY, CZ, EE, HU, LT, LV, MT, PL, SI and SK. In 2007, BG and RO became part of the EU, then HR in 2013. For Switzerland, the latest available data are for 2022.
Sources: Author's calculations based on data from the Bank of England, ECB, Federal Deposit Insurance Corporation, FRED – Federal Reserve Bank of St. Louis, Swiss National Bank and Eurostat.

Despite the large size of the European banking sector, banks suffer from structurally lower earnings profitability in comparison with their international peers. US banks enjoy a larger market share in trading activities than EU27 banks and have further increased their market dominance in recent years. The share of EU27 banks in revenues from the sales and trading of fixed income, currencies and commodities (FICC) is close to 10 % of the concentrated wallet of the leading 18 players in FICC globally (see Figure 17 left-hand panel). The picture is similar in equity sales and trading, with US banks accounting for the lion's share of the revenue wallet and the European ones collecting less than 10 % (see Figure 17 right-hand panel).

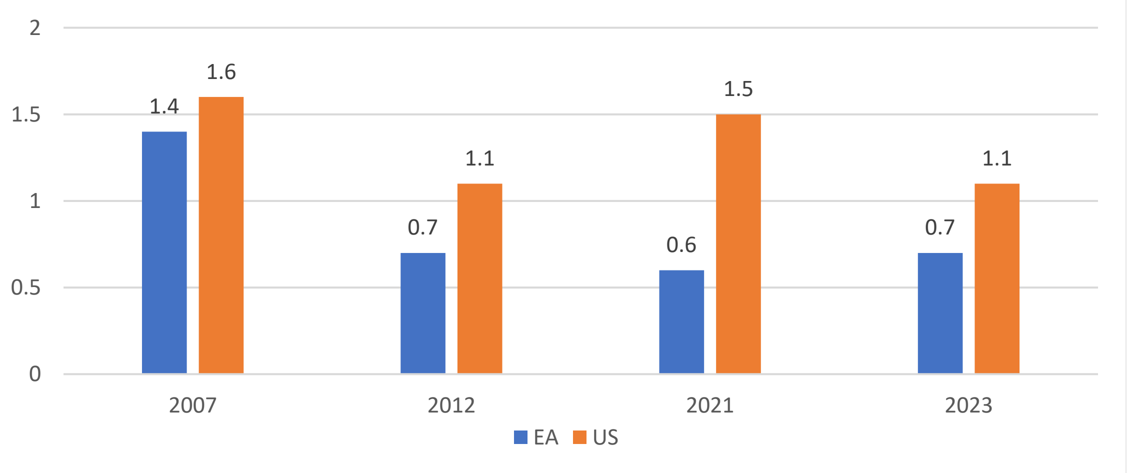
Figure 17. Cumulative bank revenues from fixed income and equity sales and trading (2022)



Notes: The figure shows the share of bank revenues based on the concentrated wallet of the leading 18 players for FICC and the leading 16 players for equities. The y-axis shows the cumulative share of bank revenues, while the x-axis shows the number of banks. UBS pre-acquisition. CSG is not shown.
Source: Presentation on 'Europe's capital markets and banks in perspective', at the ECMI 2023 Annual Conference.

The weaker performance of European banks compared with their US counterparts is also reflected in lower stock market valuations. Prior to the global financial crisis, the long-term weighted average of the price-to-book (P/B) ratios of EU and US banks stood at around 2 and 2.4, respectively. In 2007, the P/B ratios of EU banks started to fall, reaching their lowest level in 2009 (below 0.5) and have remained below 1 for almost 14 years now (see Figure 18). For EU banks, this post-crisis weakness in P/B ratios is due to weak growth and faltering bank profitability, showing that the market value of the banks' equity is trading at a significant discount compared with the book value of their equity.

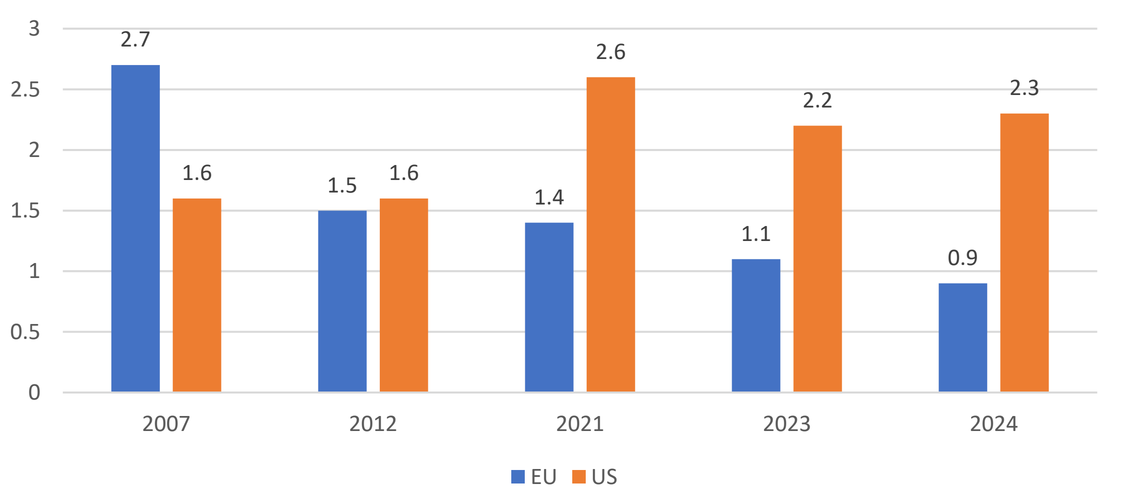
Figure 18. Price-to-book ratios in the euro area and in the US (2007-2023)



Source: Authors' calculations based on data from ECB (2023), IMF (2024), and Oliver Wyman and EBF (2023).

The market capitalisation of European banks is also shrinking compared with US banks (see Figure 19). The capitalisation of European institutions has been on a constant declining trend since the onset of the global financial crisis. From EUR 2.7 trillion in 2007, the market cap of European banks had plummeted by a factor of three to EUR 0.9 trillion by May 2024. At the same time, and although initially US banks also suffered, they were able to recover faster and reached a market cap of EUR 2.3 trillion over the same period. In other words, the market cap of US banks is 2.6 times that of EU banks.

Figure 19. Market capitalisation of EU and US banks (EUR trillion, 2007-2024)



Notes: The sample is based on all the listed banks for each fiscal year. For 2024, market capitalisation is shown as at 30 May 2024.
Sources: Authors' calculations based on data from companiesmarketcap, Oliver Wyman and EBF (2023), the presentation on 'Europe's capital markets and banks in perspective', at the ECMI 2023 Annual Conference and Eurostat.

This is also reflected in the list of global top 100 banks in terms of market capitalisation (see Table 4). The 14 European banks on the list have a combined capitalisation of EUR 634 billion, representing 10 % of the top 100 market cap. Meanwhile, the 16 US banks listed have a market capitalisation of EUR 1.8 trillion, or 28 % of the global market cap. To put things into perspective, in 2010, the capitalisation of the largest US bank was EUR 122 billion and the largest EU bank was EUR 66 billion. Fast forward to 2024, and the capitalisation of the largest US bank (EUR 530 billion) is more than seven times larger than that of the largest EU bank (EUR 77 billion), and only a bit less than the combined capitalisation of the 10 largest EU banks (EUR 541 billion).

Table 4. Location of the global top 100 banks by market capitalisation (EUR billion)

Location	2024 market capitalisation (EUR billion)	# of banks 2024	2010 market capitalisation (EUR billion)	Change in market capitalisation (2014-2010)
United States	1 850 (28 %)	16	678 (20 %)	+ 173 %
China	1 353 (21 %)	20	1 001 (29 %)	+ 35 %
Spain	170	3	143	+ 19 %
France	143	3	61	+ 135 %
Italy	126	2	51	+ 147 %
Netherlands	54	1	28	+ 93 %
Sweden	48	2	11	+ 321 %
Finland	40	1	33	+ 21 %
Germany	31	1	36	- 15 %
Denmark	23	1	13	+ 75 %
EU27	634 (10 %)	14	376 (11 %)	+ 69 %
Canada	414 (6 %)	6	205 (6 %)	+ 102 %
India	378 (6 %)	5	84 (2 %)	+ 348 %
Australia	335 (5 %)	5	203 (6 %)	+ 65 %
Japan	295 (4 %)	5	173 (5 %)	+ 70 %
United Kingdom	292 (4 %)	5	287 (8 %)	+ 2 %
Brazil	197 (3 %)	5	174 (5 %)	+ 13 %
Singapore	149 (2 %)	3	48 (1 %)	+ 208 %
Indonesia	132 (2 %)	3	13 (0 %)	+ 884 %
Switzerland	92 (1 %)	1	47 (1 %)	+ 98 %
Rest of the world	449 (7 %)	12	168 (5 %)	+ 168%
Total	*6 571*	*100*	*3 458*	*+ 90 %*

Notes: Market capitalisation of the top 100 banks is shown as at 30 May 2024 and 31 December 2010. The numbers within brackets in the second and third columns show the share of the respective location in terms of total market capitalisation. The rest of the world includes Kuwait, Malaysia, Qatar, Russia, Saudi Arabia, South Korea, Turkey and the UAE.
Sources: Authors' calculations based on data from companiesmarketcap and Eurostat.

2.2.3. *The diagnosis*

European banks' profitability is hampered by overcapacity and a competitive environment, with revenues under pressure not just from their peers but also from new entrants from outside the sector, such as fintech companies. Little international or cross-border consolidation has taken place, and this pattern has not changed since the launch of the Banking Union. Moreover, the resolution regime has not worked as well as it should, with precautionary recapitalisation being applied in a lenient way and more generally authorities preferring to use other tools to deal with failing banks outside of the harmonised resolution framework.

The focus should not solely be on large institutions. In fact, from a regulatory point of view, the EU's authorities have opted for the application of Basel principles beyond internationally active banks, something that the US has refrained from doing. While there are more than 110 significant institutions supervised by the SSM, the number of less significant ones in the EU amounts to almost 2 000. Thus, the way in which Basel principles are applied – without properly taking the principle of proportionality into account – risks putting the EU's smaller institutions at a comparative disadvantage. Although the regulatory and supervisory approach undertaken by the EU's authorities has probably helped to shield the EU's financial sector from the turbulence of March 2023, a uniform application of rules across all sizes of banks risks undermining competitiveness[8].

In addition, there is an uneven playing field among less significant institutions depending on the Member State where they are based. A clear case in point is the liquidation of Banca Popolare di Vicenza and Veneto Banca. The Single Resolution Board (SRB) deemed that there was no public interest that would lead to the entities' resolution because neither of the two banks provided critical functions, and their failure was not expected to have a large adverse impact on overall financial stability. Yet, the Italian government decided that the injection of public funds was fundamental. As the two entities were liquidated, the Banking Communication of 2013 has allowed for the injection of public funds with a bail-in solely of junior debt. This was also made possible due to the existence of resolution-like national insolvency regimes in some Member States that make it easier to opt for liquidation, which then comes with more lenient State aid treatment.

[8] It also puts smaller banks at a competitive disadvantage compared with bigger banks, which is antithetic to the very risk-based approach that is supposedly at the heart of prudential regulation.

3. EU LAWMAKING IN FINANCE AND RELATED ISSUES

- The von der Leyen I Commission has introduced and amended a wide array of financial regulations, impacting banks, insurance companies, capital markets, payments and digital assets, with a focus on prudential matters and sustainable finance.
- The EU's 'single rulebook' for financial services integrates multiple layers of legislation, with substantial reliance on secondary legislation (level 2 and 3 measures), leading to regulatory complexity across Member States.
- The digital transformation in finance, especially through AI, Open Banking, and cross-border data sharing, presents both opportunities and challenges for financial stability and market competition.
- Sustainable finance has made significant strides, with green bonds, ESG regulations and taxonomy frameworks, but issues like data availability, regulatory complexity and proportionality for SMEs remain.
- Anti-money laundering efforts have intensified, with the creation of AMLA and new rules to improve cooperation, the enforcement of sanctions and harmonisation across EU Member States.

The EU has added and updated/amended an impressive number of new rules under the von der Leyen I Commission, with a few pieces still in the pipeline (see Table 5). The regulatory framework affects banks, insurance companies, capital market operators and service providers of infrastructure, investment, payments and crypto assets (including prudential rules for banks and insurance companies). The rules on the governance of digital markets and services bring in another layer, with a special framework for digital resilience in financial institutions. On top of all that, a third layer contains rules related to the sustainable finance framework.

Table 5. New rules affecting financial services providers and markets, initiated under von der Leyen I Commission

	Adopted	Outstanding
Financial markets	CRR III/CRD VI Solvency II Review Insurance Recovery and Resolution Directive MiFIR II (single data feed and MiFID quick fixes) EMIR 3.0 European Single Access Point Listing Act (multiple voting structures) ELTIF II AIFMD II CSDR Refit Consumer Credit Directive II Instant Payments Regulation Distance marketing of financial services AMLD VI and AMLR AMLA	Retail investment strategy Digital Euro (Central Bank Digital Currency) PSD III CMDI European deposit insurance scheme Benchmark regulation MiFID II Insolvency regulation (and many level 2 and level 3 measures of recently adopted legislation)
Digital	Digital Services Act Digital Markets Act Data Governance Act DORA DLT pilot regime MiCA Regulation eIDAS and eID EU-US data adequacy agreement	Financial Data Act (and many level 2 and level 3 measures of recently adopted legislation)
Green agenda	CSRD CSDDD ESG Rating Activities Regulation Taxonomy Green Bond Standards Regulation	(level 2 and level 3 measures of adopted legislation)
Taxation	Pillar II directive Withholding tax procedures (Faster)	BEFIT

Note: For definitions or abbreviations, see list at the end of this report.
Source: Authors' elaboration.

Following the single rulebook approach, almost all basic rules in EU finance – whether a regulation or a directive – rely on secondary legislation, on level 2 implementing measures (which are delegated and implementing acts, regulatory and implementing technical standards (RTS and ITS)), and on level 3 guidelines and recommendations, along with the related Q&As documents. The only exception is the consumer credit directive, which falls outside the remit of DG FISMA. Even regulations, while directly applicable, rely extensively on secondary legislation or are often composed of 'directive'-type elements, i.e. they do not use full harmonisation. In other cases, updates are split into a directive and a regulation.

In banking, the centrepiece rules of the Capital Requirements Regulation and Directive (CRR and CRD) have well over 300 implementing measures, including guidelines (see Table 6). In insurance, Solvency II contains over 120 implementing measures, including those at level 3. In capital markets, the revised MiFID framework governing capital markets (MiFID II) is estimated to contain over 10 000 pages alone.

Table 6. Number of articles, level 2 and 3 measures under the core EU financial services acts

	Articles	Level 2 measures (RTS, ITS, Delegated Acts)	Level 3 measures (Guidelines, Opinions, Q&A)
CRR	519	53	282
CRD	165	13	88
Solvency II	311	63	57
MiFID	97	40	48
UCITS	119	22	74

Sources: Authors' elaboration based on data from the EBA, European Insurance and Occupational Pension Authority and ESMA interactive single rulebook (Solvency II has about 20 new level 2 measures as a result of a review).

A recent example of the complexity of rulemaking is the European Green Bonds Regulation, which links the EU's financial regulatory set-up with the green taxonomy. The compromise reached under the Swedish Presidency of the Council (January-June 2023) is viewed as acceptable by interest groups but remains highly prescriptive. Companies issuing green bonds under the Green Bonds Regulation will have to align the use of proceeds with the green taxonomy, which raises challenges for usability given the widespread lack of data to verify this and the issue of proportionality for smaller projects and for SMEs.

3.1. WHAT ACTUALLY IS A SINGLE RULEBOOK?

The 'single rulebook' was coined by the European Council in 2009, in the midst of the global financial crisis to encapsulate the ambition of a unified regulatory framework for the EU financial sector. The aim was to ensure the uniform application of the Basel III framework in all Member States, with identical rules. It became the standard for rulemaking in finance, with principles-based rules at level 1, to be legislated by the EU in directives and regulations, and rules or implementing measures at level 2, proposed with the help of the newly created ESAs.

The single rulebook today consists of many regulations and directives, delegated acts and technical standards, whose interpretation is facilitated by guidelines, recommendations and opinions of the ESAs. Many of the regulations and directives take into consideration national specificities and leave room for flexibility in national exemptions and derogations – the product of compromises during negotiations. An example is the recently adopted CRD VI package, which leaves many options for national implementation, for example for branches of non-EU country banks. As a result, the EU has ended up with a very complex and multi-tiered single rulebook made up of 30 national rulebooks (all EEA countries) with different specificities.

The single rulebook is in principle made up of level 1 and 2 legislation, but the notion has been extended without a clear legal basis due to the approval and publication of level 3 documents by the ESAs. It has never been legally defined in EU law or at least more clearly specified in any official document (Navid, 2023). It remains largely ambiguous and requires further conceptualisation. It is open to the vicissitudes of the political process, with politically sensitive issues moving to level 1, and unresolved matters adding to technical standards in level 2. The national interpretation of level 3 documents adds to the complexity.

In spite of a single rulebook, a single banking supervisor and SRB, there still have not been relevant cross-border mergers, meaning that market consolidation and integration has stalled. Major differences remain in national deposit insurance schemes, through options for national discretion in bank capital and liquidity requirements for banking groups, certainly for non-EU country branches, as well as in tax rules, accounting practices and bankruptcy legislation.

When compared with other major jurisdictions, in particular the UK and the US, the EU has – given its structure and need for a level playing field – legislated much at level 1, through the co-decision procedure between the European Parliament and the Council. The US, on the other hand, has managed to maintain a more principles-based approach and left implementing issues to the discretion of the supervisory agencies accountable to the US Congress. Similarly, the UK is now attempting to move back towards a principles-based system, using the common law approach. But this does not seem to be easy, as the UK currently has its own MiFID II, 'onshoring' those parts of MiFID that directly applied when it was an EU Member State (Lannoo, 2023b). The UK has only made minor amendments to ensure that the regime operates effectively in a UK-only context (e.g. moving the functions of ESMA to the Financial Conduct Authority). Revoking other parts of the rules raises a host of problems, such as the grandfathering of existing contracts.

Hence, a priority is to reduce the current pace of rulemaking, work towards regulatory consolidation and finetuning, and embark on simplification or codification[9]. It remains to be seen, however, whether a much-needed regulatory compression will take place, given the process that has been set in motion and its various spillover effects. These include the ambiguity of the single rulebook concept, the role of national law and authorities, the 3-to-5 year review clauses in almost all EU financial legislation and the unforeseeable nature of events (e.g. Covid-19 and the war in Ukraine).

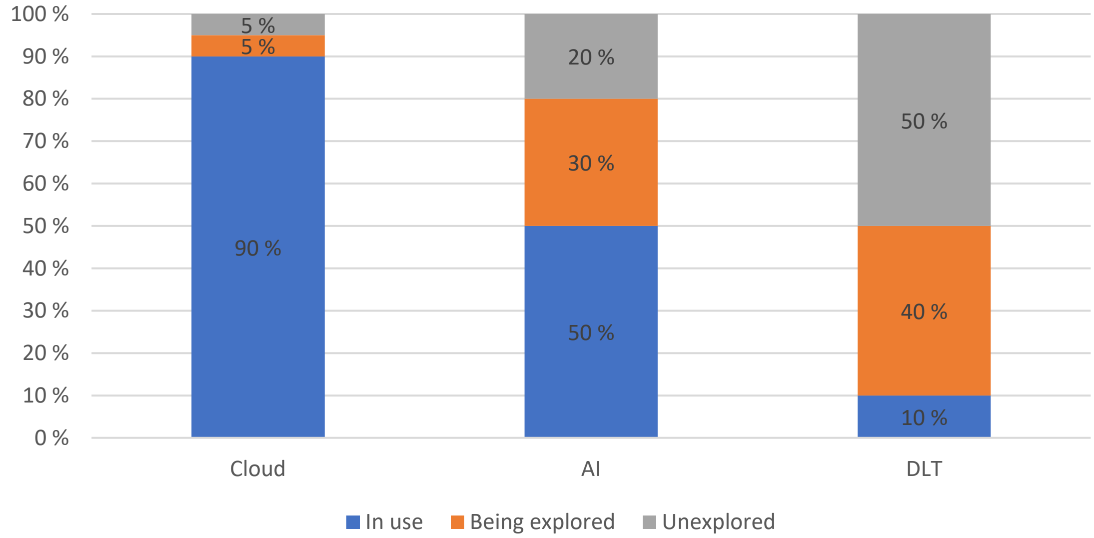
3.2. THE INTERACTION WITH DIGITAL REGULATION

Digitalisation has a growing role in the design, development and sale of innovative financial products and services, through both traditional and new digital platforms and channels. Harnessing the increasing availability of data in today's digital economy, with the advent of new technologies, such as AI, distributed ledger technology or the Internet, offers enormous opportunities.

Digitalisation brings new challenges. Cloud computing services and AI-driven solutions are increasingly applied (see Figure 20), but the EU has a problem with the cross-border dimension. It is one of the three priorities of the Letta report, which states: 'European digital services are virtually non-existent today' (2024, p. 55). Lack of integration among service providers and differences in consumer protection, geo-blocking and taxation hamper cross-border business. Given the increasing digitalisation in financial services, above all on the B2C and C2C sides, providers could be hindered in both aspects at the cross-border level. Those with a large single market in the home country may be best placed to exploit the opportunities, in view of their scale.

[9] We define 'regulatory consolidation' as the process of merging, integrating or streamlining multiple regulatory requirements and frameworks into a single, cohesive set of regulations, possibly under a single regulatory body. This process aims to simplify compliance, reduce redundancy and improve the efficiency and effectiveness of regulatory oversight.

Figure 20. Adoption Rates of Innovative Technologies by Banks (excluding Generative AI)



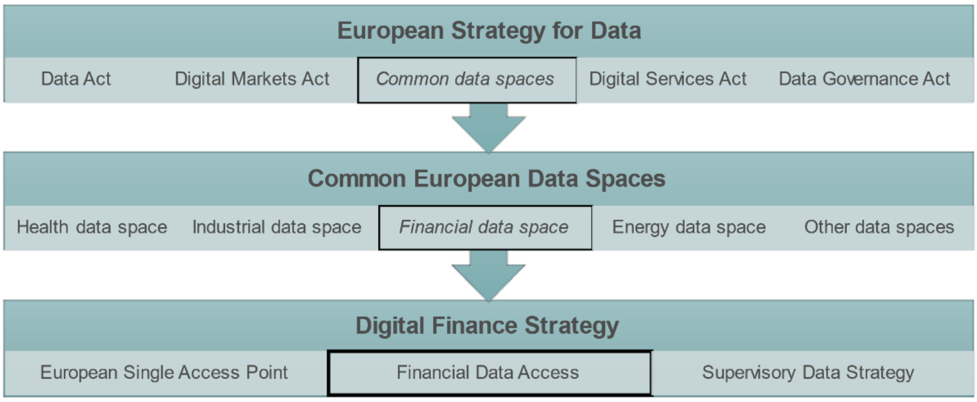
Source: Authors' elaboration based on data from the ECB.

According to the ECB, depending on technological penetration and the concentration of providers, AI can pose risks in terms of financial stability. In particular, the increasing use of AI in the banking sector, combined with the concentration of foundational model providers, increases the likelihood that the AI decisions of financial institutions will be affected by the same biases and technological issues.

On top of the potential financial stability risks stemming from technology penetration and concentration, the interaction between digital and financial regulation is not well understood. There is an overall strategy for data, enshrined in core rules for the functioning of markets and service providers – the Digital Markets Act and Digital Services Act (see Figure 21). The Digital Markets Act introduces the concept of gatekeepers. These are large companies that need to enforce rules and meet data sharing requirements to ensure a level playing field. The obligations on gatekeepers could facilitate market entry for other (smaller) enterprises. The Digital Services Act sets differentiated rules that platform service providers must comply with, proportionate to the size of the company. These cover fundamental rights, transparency and efforts to combat illegal practices, and ensuring free competition. Companies offering financial services on-line are required to have a specific licence but will be affected by the Digital Services Act as well.

The use of data is governed by the Data Governance Act and the Data Act. The former regulates processes and structures that facilitate voluntary data sharing and interoperability. It creates a framework for data intermediation service providers in a secure processing environment where companies or individuals can share data. The latter clarifies who can create value from data and under which conditions. It allows users of connected products, consumers and professionals to have the option of choosing more cost-effective repair and maintenance providers, insurance or related services. A private car, for example, collects enormous amounts of data about its use and its user(s), which can be shared with and utilised by third-party providers.

Figure 21. EU policy context for data



Source: European Commission.

On the financial services side, today data sharing is only allowed under the second Payment Services Directive (PSD-II) (Open Banking). Core rules on the digital side for finance providers concern PSD-III and the financial data act (FIDA), both still under discussion, and the Markets in Crypto Assets (MiCA) Regulation and the Digital Operational Resilience Act (DORA). The fundamental priority for the European Commission is to open financial services markets and to assure a level playing field between banks and non-banks. PSD-II introduced rules on data sharing, based upon strong customer authentication rules (a two-step process) for open competition in payment markets. The draft FIDA further expands these rules to enable customers to have control over their data in order to access data-driven services beyond payments (Open Finance). FIDA would introduce a licence for 'financial information services providers' (FISPs), which would be subject to rules covering their conduct, governance and organisation.

Despite the fact that Open Banking and Open Finance share a similar philosophy, they differ in an important respect. Open Banking is based on a non-contractual access right without any cost. In the case of Open Finance, the FIDA proposal would require that the entities holding the data (for example, a bank) and the entities using the data (for example, a financial information services providers) reach contractual agreements for sharing financial data, where the data-holding entities can demand reasonable compensation for the costs of making the data available. These differences are expected to be kept in the current PSD-III and FIDA proposals.

The EU appears ready to move beyond Open Banking and embrace data sharing in other areas, but this must be done carefully to avoid market distortions, especially in credit markets. Key aspects of the FIDA proposal require further consideration (Arnal and Andersson, 2024):

(i) clarifying 'customer data' and ensuring it does not compromise data quality, credit access, or stability;
(ii) ensuring reciprocity in data sharing for gatekeepers' FISP licenses;
(iii) favouring a gradual approach over a Big Bang;
(iv) considering extended periods and safeguards if a Big Bang is adopted;
(v) monitoring compensation models to avoid stifling innovation;
(vi) merging frameworks while protecting third-party models;
(vii) safeguarding consumer data and ensuring fair access.

MiCA and DORA have already been agreed upon but implementing measures are still to be rolled out. DORA was very much designed to be a principles-based regulation, but it also ended up having 12 different level 2 mandates for technical standards and delegated acts. The highly detailed technical requirements stemming from the draft RTS/ITS are seen to be disproportionate for smaller and simpler (non-bank) business models.

Moreover, from the side of supervisory authorities, DORA will also lead to substantial changes. DORA will streamline supervisory tasks by allowing direct EU-level oversight of critical technology providers starting in January 2025, simplifying the current complex process of supervising cloud service providers through bank contracts (Arnal, 2023a). However, DORA will also increase the workload for supervisory authorities, who will need to find already scarce IT specialists.

In the case of MiCA, there are 40(!) different pieces of level 2 legislation or guidelines, prepared by the EBA. The RTS/ITS of MiCA also affect traditional financial services providers as they concerns e-money tokens, or hard currency payment systems, asset-based tokens and tokenisation in securities markets, for example. Even though MiCA is the most comprehensive regulatory framework globally, it does not offer the same level of investor protection as for financial assets[10]. Additionally, MiCA does not prevent cryptoasset service providers from non-EU countries that do not comply with its requirements from offering services to the EU public. Also, the regulatory approaches of other major jurisdictions differ from the EU's. These differing approaches reflect each region's priorities but could affect financial stability and create loopholes in investor protection (Andersson and Arnal, 2024). Therefore, EU authorities should prioritise the promotion of global regulatory convergence.

[10] There is no investor guarantee fund, supervision of price manipulation is lenient due to the lack of transaction reporting and custody requirements are less stringent.

The financial sector is furthermore concerned by the recently approved AI Regulation. The AI Regulation follows a risk-based approach, classifying AI systems into four different categories: (i) unacceptable risk (e.g. social scoring systems), (ii) high risk (e.g. systems used in critical infrastructure), (iii) limited risk (e.g. chatbots), and (iv) minimal or no risk (e.g. spam filters).

Among all the high-risk systems identified in the AI Regulation, one kind will have a special impact on the financial sector. This is systems related to the creditworthiness assessments in banking activities and risk management, and pricing in life and health insurance. Although the AI Regulation lists the obligations that providers and users of high-risk AI systems must meet, detail on what is regarded as AI is expected in forthcoming delegated and implementing acts. For example, logistic regression models are frequently used in creditworthiness assessments, but it is still unclear whether these models will be considered AI or not. If they are AI, the operational model of credit rating agencies could be impacted, given the heavy compliance burden for using such econometric models.

In capital markets, data management has long been a core aspect and AI was in place even before it was called that, in algorithmic trading. The supervision of data use in markets and management of data are huge tasks for supervisors, and priorities for effective supervision in an open capital market. Circuit breakers have become a tool used by trading venues to safeguard against market volatility, with the calibration and methodology monitored by competent authorities. In line with its MiFID II mandate, ESMA has enacted rules (RTS No. 7) for common understanding and enforcement practices among supervisors on the matter (ESMA, 2023b).

ESMA now is tasked with setting-up in a single data feed, a near real-time securities market price tracker (or a consolidated tape) and the European single access point for market-sensitive information. Advanced digital solutions will be needed for both of them, with large data providers offering their services under a licencing regime. Both require enhanced expertise on data governance at ESMA. And both initiatives raise questions as to why a public authority rather than private market participants should deliver such services, i.e. what is the market failure and what is the least costly approach?

In light of the large number of digital rules passed in the last few years, of a general as well as sectoral nature, the coming years will be about implementation and the interaction between the different rules, which remains unclear for many.

3.3. A VAST GREEN AGENDA

The von der Leyen I Commission made dramatic advances on the green agenda. In the domain of finance, the EU adopted green disclosure rules in the Corporate Sustainability Reporting Directive (CSRD). It obliges banks in the CRD VI to have ESG transition plans and reporting (with proportionality for smaller banks). It has also introduced a favourable risk weight for green projects, subject to additional requirements. The EU Taxonomy for Sustainable Activities is supposed to determine what can be considered green, but the reality is that market participants make their own call[11]. Work is underway to ensure interoperability between the European and international standards, coordinated by the International Sustainability Standards Board.

The CSRD of 2023 introduced double materiality in reporting financial and sustainability impacts – the potential effects of a company's activities on nature and society. The sustainability disclosure agenda builds upon the Non-Financial Reporting Directive of 2014 and the Sustainable Financial Disclosure Regulation of 2019. Continuing the work started under the Juncker Commission, the von der Leyen I Commission published the Taxonomy Regulation on what is sustainable, which has since been accompanied by five delegated acts. Today, the CSRD, the SFDR and the Taxonomy Regulation mark the three essential components of the ecosystem of sustainability reporting.

The politicisation of the delegated acts has led to complaints about over-regulation and negative impacts on the competitiveness of companies. This is linked to the taxonomy's complex do-no-significant-harm criteria, which result in very few economic activities classified as taxonomy-compliant. Moreover, companies are required to implement the requirements of the taxonomy and the CSRD with its detailed European Sustainability Reporting Standards (ESRS) at the same time, which is pushing them to and sometimes even beyond the limit of their capacities. On top of that, the requirements under the Corporate Sustainability Due Diligence Directive (CSDDD) could entail large costs, even for SMEs, despite the good intentions.

Yet, we would argue that a clear sustainability standard, under double materiality, is a big step forward in disclosure and could be a long-term advantage for European companies in accessing market finance. Nevertheless, a balanced and proportionate regulatory approach must be ensured as well as a sufficient and realistic time frame enabling companies to thoroughly implement new rules.

The data required to calculate the key performance indicators for climate change mitigation and adaptation are not easily available, and even less so for SMEs (the CSRD is

[11] The Sustainable Financial Disclosures Regulation defines what sustainable investment is, but in Article 2(17) it leaves scope for market participants to determine their own criteria for what sustainable investment means (without consideration of the taxonomy).

applicable from 250 employees upwards) and non-EU based companies. For this reason, and in order for companies to have more time to implement the cross-cutting ESRS, the adoption of the sector-specific ESRS has been postponed for 2 years.

Also, in this domain data governance requirements are substantial for supervisors, notably for sustainability information. This adds to the scope of tasks that financial oversight bodies already have for financial information, coordinated at EU level by a Committee under the auspices of the European Commission, in which ESMA is also represented (European Auditing Oversight Bodies Committee). However, there is no single oversight authority today in charge of ensuring harmonised rules for supervision of the audit profession.

At the global level, various jurisdictions have undertaken efforts to design green taxonomies, leading to concerns about market fragmentation. The EU's efforts have certainly set a standard globally, and national and international organisations have worked to align taxonomies. The EU and China have developed a Common Ground Taxonomy, by highlighting major areas of commonality between them, to enhance the interoperability and compatibility of the taxonomies used in two large, green finance markets. Recently, EFRAG and the IFRS have published joint interoperability guidance on the alignment of disclosure requirements.

3.4. TIGHTER ANTI-MONEY LAUNDERING RULES

Somewhat aside from the core financial regulatory package are the updated rules on anti-money laundering, the creation of a new agency (i.e. AMLA) and the sanctions on Russia and Belarus. Although the adoption of the fifth Anti-Money Laundering Directive in 2018 marked a significant milestone in the development of the EU-wide framework to combat money laundering, it quickly became evident that substantial gaps remain. The incomplete implementation by several Member States, inconsistencies in how the rules are applied across the EU and the absence of stringent penalties for non-compliance continue to hinder the establishment of an effective and robust EU system for anti-money laundering and countering the financing of terrorism.

Since 2018, geopolitical developments and rapid technological progress have dramatically increased the financial sector's exposure to financial crime risks. The EU's response to the Russian invasion of Ukraine in February 2022 included the imposition of sanctions that are unparalleled in their scale and reach. Still, the enforcement of these sanctions has revealed significant disparities among EU Member States. The lack of a unified approach to implementing these restrictive measures has led to differences across the region, further complicating compliance efforts. This fragmentation puts considerable strain on financial institutions, as they must navigate varying national regulations while ensuring that they meet the EU's overarching requirements. The result is a heavier burden on compliance resources, which must adapt quickly to evolving risks and regulatory expectations in an increasingly interconnected global landscape. But this is about to change with the establishment of AMLA, as well as stricter anti-money laundering rules.

The new, recently adopted package on anti-money laundering consists of the sixth Anti-Money Laundering Directive, the EU 'single rulebook' regulation and the creation of AMLA. It aims to assist financial intelligence units (FIUs) and facilitate cooperation among Member States. AMLA should work with financial institutions, the obliged entities, to increase the efficiency of anti-money laundering work. Technology provides ample possibilities to better fight money laundering. These range from simple steps, like allowing the use of electronic IDs for most individuals to verify their identity, to more complex measures, like raising the standards for registers of beneficial owners. It is also important that AMLA and the SSM, as well as national supervisory authorities and FIUs establish a close relationship.

The new rules are designed to ensure compliance with targeted financial sanctions and make avoidance of sanctions a criminal offence. But AMLA faces an uphill struggle to achieve a consistent implementation of the new rules in conjunction with FIUs[12] and to add non-EU countries to the picture. AMLA will assess the riskiness of the anti-money laundering framework in non-EU countries and will provide support, promote information sharing and recommend the blacklisting of countries. For example, evasion of sanctions through the Western Balkans and Turkey is widespread. AMLA and its Balkan counterparts will have to coordinate their actions closely with the US FinCEN, the Financial Action Task Force and the FIUs in each EU Member State. In addition, foreign direct investment (FDI) into the EU will need to be added to the toolkit. The EU now has a regulation in place on screening FDI, but authorising remains the exclusive responsibility of the Member State where the investment takes place and portfolio investments are not covered.

[12] Although AMLA's primary task is not explicitly to align FIUs, part of its role involves working closely with FIUs to ensure consistent and effective implementation of regulations on AML/CFT. This includes standardisation of reporting, coordination and information sharing, to achieve greater alignment among FIUs, also globally.

4. FINANCIAL SECTOR SUPERVISION IN THE EU

- Since the financial crisis, the EU has implemented a robust financial supervisory framework involving the SSM, the ESAs and the Single Resolution Board to oversee financial markets.
- The SSM monitors banks, ESMA covers securities and asset management, and EIOPA focuses on insurance and pensions, with new regulations adding oversight of critical IT providers.
- Despite progress, there is a need for more risk-based supervision, clearer expectations, and more transparency, with calls for the SSM to be more proactive and improve its approach to potential bank failures.

4.1. THE ROLE OF EUROPEAN SUPERVISORY AUTHORITIES

Since the financial crisis, with the establishment of the European System of Financial Supervision and the SSM, a new framework has been in place to continuously monitor Europe's financial markets. Some 2 600 people (at the end of 2022) are actively involved in financial supervisory and regulatory functions at the EU level (mainly in the SSM, but also in the ESAs and the SRB), where there had been very little before. Europe's banks are permanently monitored by the SSM and EBA, while ESMA watches asset management, securities markets and specific market segments, and supervises certain operators. The European Insurance and Occupational Pensions Authority (EIOPA) sits on the supervisory colleges of 64 insurance groups that have a head office in either the EU or EEA. Moreover, following the implementation of DORA as of January 2025, the ESAs will also be in charge of supervising critical third-party IT providers.

The impact of this new set-up is a more tightly controlled financial sector. Whether the sector has become more resilient depends on the parameters used in the assessment and the circumstances. The latest results of the EU-wide stress test exercise conducted by the EBA and the ECB provides a reassuring picture (Lannoo, 2023a), but stress tests have misled authorities on earlier occasions. After the market stress in mid-March 2023, according to the ECB and EBA there was no reason to be concerned about the health of the European banking system. Bank capital positions are strong (15 % for Common Equity Tier-1, CET1), with still 10.4 % in adverse circumstances. The leverage ratio stands at 5.5 %, going down to 4.4 % in adverse conditions. Profitability is steadily increasing with the return of positive interest rates and will be further boosted by the very generous returns on the ECB's deposit facility.

Nevertheless, this rosy picture does not mean there is no room for improvement. As indicated in the independent external evaluation report on the SSM, there is a need to move from a more rigid and legalistic approach in supervision towards a risk-based one, improving the efficiency of the Supervisory Review and Evaluation Process, better integrating the results of other supervisory activities into the analysis conducted for it and providing clearer supervisory expectations to banks. More disclosure by the SSM in its supervisory practices is also required. In addition, the SSM needs to act earlier, when it comes to declaring banks as failing or likely to fail. Markets have on many occasions been front running the SSM. Prompt corrective action must be enforced in order to put pressure on the banks to raise capital, when the banks still have value. Waiting till solvency falls to zero or there is a run should not be an option. Furthermore, climate and cyber risks need to be better quantified, sovereign exposures monitored carefully, and macro prudential risks watched.

EIOPA, for its part, organises stress tests for some 43 European insurance groups, representing 75 % of the EEA market. It expects European insurers to be able to maintain their financial health even amid harsh economic conditions, while upholding their ability to meet commitments to policyholders, and it makes a series of recommendations to national competent authorities. EIOPA also carries out climate stress tests on pension funds. ESMA organises stress tests for CCPs, assessing the resilience of both EU and Tier 2 non-EU Country CCPs to a wider range of risks to identify potential shortcomings in their set-up/risk management. New in the latest exercise is the inclusion of climate risk, in addition to assessing liquidity, credit and concentration risks. ESMA furthermore organises stress tests for money market funds.

ESMA has the highest number of direct supervisory tasks among the ESAs, and the list is still growing. It supervises credit rating agencies, trade reporting registers, data providers (approved publication arrangements) critical benchmark administrators and systemic non-EU country CCPs. Soon it will also supervise consolidated tape and ESG rating providers (from 2025, respectively 2026) and operate the European single access point. And there are calls, in the context of the CMU revival discussions, to give ESMA a listing authority, as a kind of 28th or competing regime to the national authorities.

To enhance supervisory convergence, the ESAs have been given the power to police national competent authorities in the 'peer reviews' (Article 30 of the ESA regulations, further amended in 2018). A peer review committee is authorised by a board of supervisors and shall do 'peer reviews of some or all of the activities of competent authorities, to further strengthen consistency and effectiveness in supervisory outcomes'. Peer reviews by the ESAs are detailed in a peer review methodology, and an overview is given in the annual work programme. Peer pressure also builds on a day-to-day basis in the many standing committees.

ESMA has been the most active of the ESAs in peer reviews of national competent authorities. There was the Wirecard case in 2020, when ESMA signalled deficiencies in the supervision of BaFin, followed by the recommendations to the Cyprus market authority in 2022 on the supervision of cross-border activities of investment firms. However, the budgets of ESMA and EIOPA are limited to two to three peer reviews a year. In the same vein, the reviews of the CRD and Solvency II give ample new tasks to the EBA and EIOPA, limiting capacity for work that supports supervisory convergence. Others have commented that supervisory convergence model of ESMA may have become remote, as a function of bureaucratic expansion, posing risks to effectiveness and legitimacy challenges (Moloney, 2018).

4.2. A PROPORTIONATE APPROACH

Proportionality is a basic principle of EU law, meaning that the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties (Article 5 TFEU). In EU financial regulation and supervision, the principle has been enshrined for some time, but its concrete application remains difficult, given the need to maintain a level playing field. With the growing complexity of EU law making, as a result of the single rulebook, its importance has come to the foreground in policy debates again. It is also important in the context of the expanding role of market finance, which requires a different ecosystem from bank finance, with a variety of players, large and specialised.

In regulation, a proportionate approach means tailoring regulatory requirements to an undertaking's size, systemic importance, complexity and risk profile. Here, the aim is to avoid excessive compliance costs or regulatory burdens for smaller and non-complex banks without clear justification. But it also means more restrictions in the scope of activities for smaller players, and possibly higher requirements.

In supervision, proportionality could be an implicit or explicit bias. Before the crisis, large banks benefited implicitly from a too-big-to-fail bias, to the detriment of smaller banks. This was exemplified in the leverage ratios. And even until today, banks based in smaller countries complain about higher capital requirements, as their parent country has limited fiscal clout.

The reference to proportionality in legislation on EU financial services has grown. Since CRD IV, the principle has featured prominently in EU banking rules, and in successive updates. In financial supervision, it is a key principle for the SSM, which is required to 'use its supervisory powers in the most effective and proportionate way' (SSM Regulation, Recital 55), with supervisory intensity varying according to a bank's size and complexity. It distinguishes between significant and less significant institutions, with requirements adjusted to the risk profile and size.

In market regulation, proportionality was applied to the SMEs in the Prospectus Regulation amendments of 2017 – a 'prospectus-lite' for SMEs – which is further pursued in the latest Listing Act. The 'Growth Prospectus' seeks to reduce disproportionate disclosure obligations on small companies while no reducing investor protection. Recent research has found that less complex prospectuses for SMEs are no less informative. At the same time, the research also indicates that there is no relationship between listing activity and regulatory overreach, and that decline in IPOs is not a result of complexity (Kaserer, 2024).

Proportionality is enshrined in reporting requirements too, with no or more limited reporting for smaller enterprises, which is likewise the case for sustainability reporting in the CSRD.

5. A LOOK AHEAD

- The EU must clarify what competitiveness means. To boost it, the EU must balance regulation with market growth and innovation.
- Effective regulation should protect investors and maintain stability without stifling market competitiveness; a 'competitiveness test' may help manage over-regulation.
- The EU is exploring unified supervision of securities market to improve capital markets and investor protection, addressing fragmented national oversight.
- The success of products like UCITS and ELTIFs depends on overcoming national regulatory barriers and tax issues to enhance their effectiveness.
- Improving financial and ESG data infrastructure is key to market transparency and competitiveness, including addressing gaps in oversight of accounting and auditing standards.

5.1. WHAT IS COMPETITIVENESS FOR FINANCIAL MARKETS?

The big mantra for the incoming European Commission is competitiveness, but what is competitiveness? For many, it is shorthand for reducing regulatory overkill, or is inversely related to regulation – i.e. the more rules, the lower the profits – or refers to the EU's intensive rulemaking for the digital and green transition outpacing its corporations.

The competitiveness of companies is too easily assimilated into that of countries, where it is entirely different (Krugman, 1994). Countries can be competitive in various ways, but what is the metric? For a company, it is the bottom line or EBITDA, its market share and growth. For countries, it is the wellbeing of its population, for which different measurements exist. The most often-used indicator is gross national product (GNP), but even here, there are assorted ways to measure it (e.g. per person, working population, per hour worked and purchasing power parity) and international comparisons have the problem of adjusting for exchange rate differences. A country can be competitive while having an enormous trade deficit (e.g. the US). But also the distribution of wealth and its evolution are notable, where important differences remain in the EU and country-wise (see the ECB's recent household wealth data and Gini coefficient). A median increase in household wealth could be more consequential than absolute GNP growth.

In a European context, the impact of rulemaking on competitiveness needs to be qualified. In theory, the EU harmonises only essential rules in a principles-based approach, and mutual recognition does the rest. Over-regulation is a misuse of the hierarchy of norms in the single market. It is the result of a process of mistrust between the Member States, where the alleged non-functioning of the single market leads to a subsequent reaction by the Commission and the EU legislative bodies to enact new regulation. An example is MiFID, which has become extremely detailed in its latest version, but has not led to more market development. The Letta report therefore proposed to have a 'competitiveness test' to ensure an appropriate balance between ordinary legislation and delegated or implementing acts, thereby maintaining the flexibility needed to enable rapid responses to innovation (2024, p. 35).

In finance, the growth and competitiveness objective is one part of the considerations the ESAs need to take into account in their activities (see recital 13 of the EBA Regulation). It raises the question of the measure used to assess the impact of financial regulation on competitiveness. Finding the appropriate balance of requirements for operators with depositor or investor protection brings us back to the discussion above about proportionality. For capital markets, maintenance of high-level investor protection standards is key, as regulatory arbitrage undermines trust. In banking, looser standards affect financial stability, as was exemplified in the US in March 2023. This indicates that transparency and accountability in financial regulation are primordial.

In its contribution to the CMU debate, ESMA (2024a) recommended that the European Commission and legislative bodies incorporate mechanisms into their work that, consistent with global standards, support the competitiveness of EU capital markets while at the same time ensuring financial stability. ESMA expressed its willingness to continue to consider the impact of its activities 'on the Union's global competitiveness' (albeit not seeing a need for an explicit competitiveness mandate for itself, see Recommendation No. 20, ESMA, 2024b). In this respect, the stance taken by ESMA is less ambitious than the one advocated by the Noyer report (2024), which supports entrusting ESMA with an additional mandate in favour of competitiveness that could also strengthen the efficiency and proportionality of its interventions.

Hence, it will be important to clarify how competitiveness is defined, what the measure is, and how this applies to the financial sector. UK legislators have recently reviewed the position of the sector and set competitiveness and growth as a secondary objective in the Financial Services and Markets Act 2023 (TheCityUK, 2024). It is debatable whether this approach should be followed in the EU. The financial sector is there to support economic growth and wellbeing.

Related to competitiveness is market openness. The higher the awareness of competitiveness, the less the need to restrict market access, or to adopt localisation policies. Strategic autonomy is high up on the EU's agenda, but the degree of dependence on non-EU country providers is limited in finance. The market share of non-EU banks (i.e. branches and subsidiaries) in the EU was 12.2 % of total banking assets (data as of June

2021; EBA, 2023)[13]. More recent data show a decline in capital flows to the EU, and a reduction in its capacity to attract FDI and portfolio investment, although it is unclear what the causes are (Alcidi *et al.*, 2024). Non-EU country access to the European market has been rendered more difficult in recent legislation. Openness would in the first instance be important to the UK and the City of London, as the second largest global financial centre, but only one form of equivalence in EU-UK market access is left, for CCPs. The signing of a Memorandum of Understanding between both sides is a welcome step towards more equivalence agreements and cooperation.

The situation is very different with respect to the asset management sector. The non-EU based providers, especially from the US, have seen an impressive increase of their market share in the last decade. For example, in the case of equity funds domiciled in the EU, more than 40 % of the EU market was controlled by US players in 2023, highlighting the competitiveness problem of EU-based providers. In EU countries where non-EU players have a bigger market share, the allocation of portfolios towards non-EU companies is much higher (i.e. each player brings its own expertise on the market it knows best). Conversely, European market shares in the US do not exceed 2 % (Noyer, 2024).

5.2. A REMEDY FOR LEGISLATIVE FATIGUE AND OVERKILL

Better enforcement of rules would reduce pressure for more rulemaking and hence legislative fatigue. But the increasing complexity and volume of EU regulations often hinder their effective implementation. Appropriate supervision of recently adopted rules, such as the 'payment for order flow' or inducements, are very demanding for competent authorities. This is even more problematic because of the single rulebook and the ambition to create a Banking Union and a CMU.

Better enforcement has featured high on many European Commission agendas for quite a while. Several measures have been proposed to enhance application, along with remedial mechanisms to prevent non-compliance and to consolidate enforcement mechanisms. Proposals are circulating for a quick application of EU law, through single market offices at both the national and EU levels, to ensure greater responsiveness. In the same vein, an enforcement commissioner has been suggested for the von der Leyen II Commission. Infringements should also be settled more rapidly.

The idea of simplifying legislative acts has also been around for some time, through the SLIM (Simplification of Legislation for the Internal Market) initiative and related exercises. The Letta report (2024, p. 130) distinguishes two possible examples: the first is redundant, obsolete and inconsistent regulations that could be eliminated, possibly via omnibus legislation; and the second is an initiative focused on 'political' simplification,

[13] With a higher share only for certain specific activities, for example, 31.4 % in derivatives trading.

which necessitates comprehensive debate on the fundamentals. Both cases have already been discussed at length but neither are applicable to financial regulation. Omnibus legislation, when discussed in the context of the financial sector, is used for common amendments to different pieces of legislation and for understanding of the single rulebook.

More crucially, and as with new rules, a cost-benefit exercise will have to be carried out to quantify the cost cutting and go beyond the conventional wisdom. There is the cost of adapting to the changes and the legal implications compared with the possible benefits of streamlined rules. In some cases, the rationale for certain rules may have been forgotten.

There should be no illusion that legislative fatigue can be addressed easily. Earlier periods of deregulation in finance turned sour afterwards, such as under Commissioner Charles McGreevy's term (2005-2009), when complaints about too much rulemaking were taken on board. McGreevy preferred to have a Code of Conduct for CSDs, which delayed single market rules for these entities. In early 2023, the calls for more lenient bank capital requirements in the EU to face competitive disadvantage compared with the US (Oliver Wyman and EBF, 2023) were premature, and must be examined carefully. The reality is that capital requirements for large US banks have for many years been higher than for large EU banks (e.g. as a result of the output floor as well as stress tests).

5.3. A SINGLE SUPERVISORY SYSTEM FOR SECURITIES MARKETS

Creating an integrated European system for securities markets supervision is now considered as one of the options to strengthen the fabric of Europe's capital markets, 10 years after the start of the SSM for banking. Compared with the attractiveness of the US capital market, for European investors as well, Europe has failed to create a sufficiently solid environment to grow its own markets.

The successful operation of a capital market is what many countries want, but few manage. Unlike the supervision of institutions, where it is a matter of setting prudential standards and enforcing them, a capital market is an ecosystem where the expectations of issuers of securities and investors in securities meet. This requires the presence of many different actors in distinct layers of securities markets, a well-regulated financial infrastructure and market intermediaries, as well as effective self-regulatory organisations and government institutions. The US experienced many booms and busts before enacting federal securities laws in the 1930s, which took another 40 years to become powerful through the rise of the US securities markets in the 1970s, when it became the reference.

The EU financial system is bank dominated, whereas banks are of lesser importance in the US system. There are merits to both bank- and capital market-dominated systems. Banks have historically been important for growth in Europe. In most cases, banks are better at arm's length finance and servicing customers during downturns. However, capital markets can at times serve as a spare wheel when there is a banking crisis. Bank balance sheets are not good at supporting capital market instruments. Bank liabilities are liquid and nominal. Capital market assets are illiquid and give the right to a share of something.

It is beyond doubt that the EU has advanced a lot from the time that the role of stock markets differed importantly, or when insider trading was not an offence in several of its Member States. It has enacted many laws and created the European Securities Markets Authority in 2010. But to advance, investors need to be protected on an equal footing across the EU (Letta, 2024, p. 55). Barriers to market integration need to be tackled. How to move forward remains a question that requires further investigation. Areas to be considered are the supervision of post-trading infrastructure (i.e. CCPs and CSDs), trading venues of a European scale, and securities and investment products specified in EU law.

Too many competences remain with national supervisors, which have not kept pace with market needs and developments. The supervision of trading platforms and CSDs remains fully in national hands, while infrastructure has grown far more integrated since the creation of Euronext in 2000 and the Sicovam-Euroclear merger. The same can be argued for investor protection: the increased integration of markets have not been matched with investor redress procedures. Where companies and their boards, auditors or banks fail through dysfunction, shareholders should have access to effective collective redress systems that are pan-EU.

5.4. PAN-EUROPEAN SAVINGS AND LONG-TERM INVESTMENT PRODUCTS

A pan-European savings or investment product, while advocated for some time, has struggled to gain widespread use due to a variety of barriers. These include the diversity in savings habits across European countries, the variety of national tax schemes and the role of financial intermediaries such as banks, insurance companies, brokers and advisors. Lastly, the variety of occupational pension plans across the EU, with differing structures and incentives, makes it challenging to create a single product that is attractive and practical for widespread use.

UCITS can be considered a successful pan-European investment product, accounting for approximately 75 % of all collective investments by retail investors in the EU, while its success outside the EU is also growing – in particular in Asia and South America (EFAMA, 2023). However, despite their investor protection measures, regulatory standards and transparency requirements, national discrepancies in terms of marketing and conduct rules, taxation, distribution channels and supervision prevent UCITS from being the same across EU markets. Even if the European Commission has tried to stimulate the cross-border nature of UCITS as a true pan-European product, this has only succeeded to a very limited extent (ECA, 2022). UCITS have too often been developed by banks and insurance companies as marketing tools rather than cost-efficient savings products. For UCITS to be the latter, their scale and cost, and the fiduciary duty should be much more closely watched, and supervisors should be stricter in authorisation and oversight of performance.

The EU has tried to follow on the success of UCITS with the creation of ELTIFs, but has not succeeded so far[14]. Fewer than a hundred ELTIFs have been authorised since their creation in 2015, with a total value of about EUR 13 billion (Scope Group, 2024). The problem with ELTIFs, as funds for less-liquid assets, is finding a good redemption policy. The ambition now is to revise ELTIFs by adjusting the measure, hopefully preceded by a good impact assessment. The PEPP has faced the same fate, with only one(!) PEPP in circulation since its inception in 2021.

Both the ELTIF and PEPP, but also UCITS raise core policy issues of product design, decision processes on asset allocation and conduct, and the role of supervisory authorities. Although they concern harmonised product rules for the EU, the prudential supervision matters are largely left to the Member States, certainly for UCITS. This has only gradually been filled in through amendments to UCITS, and in peer reviews by ESMA and EIOPA.

The legislative decision process needs to be closely monitored, as narrow interests in this domain may try to derail measures by lobbying individuals and groups in the European Parliament or in the Member States. This happened for example with the PEPP proposal in 2018-2019. What was initially designed as an interesting proposal, became unattractive. Certain interest groups feared the attractiveness of the PEPP and added clauses to the final text to constrain its reach, excluding for example the possibility of using a PEPP as a second-pillar pension product. It should have led to a withdrawal by the European Commission, or at least an amended proposal, as we argued in 2019 (Lannoo, 2019).

Taxation is one of the other determinants of a successful long-term savings product. Such tax policies are set at the Member State level, and hinder the emergence of pre-paid pension plans or the cross-border provision of savings products that do not have similar tax benefits.

---

[14] That said, the two products serve different purposes and target different investor bases. UCITS have shorter investment horizon, offer daily liquidity and are targeted at retail investors. ELTIFs have a long-term investment horizon with limited redemptions and are primarily targeted at professional investors.

5.5. WHAT'S LEFT FOR A BANKING UNION?

Within banking there are two key issues that need to be addressed: implementing a resolution system that does not leave the bill with the taxpayer, and making life easier for the small banks that help keep local communities alive.

The intention with the Bank Resolution and Recovery Directive was to make the shareholders and creditors pay, rather than the taxpayer, when a bank fails. To date, there have only been two real resolution cases in the Banking Union: that of Banco Popular Español and that of the Slovenian and Croatian subsidiaries of Sberbank (it was decided that it was not necessary to resolve the Austrian parent of Sberbank).

However, this is not because there have been no other entities in crisis. On the contrary, other entities have been declared unviable, notably the Latvian banks ABLV and PNB Banka, and the Italian banks Banca Popolare di Vicenza and Veneto Banca. Yet, considering that there was no public interest in these cases, these entities were liquidated by national authorities according to their respective national legal frameworks, and in some cases with a generous use of taxpayer's money, instead of being resolved by the SRB based on common European regulations. In reaction to these cases, the proposal for crisis management and deposit insurance (CMDI) seeks to broaden the concept of public interest and increase the burden of proof on the resolution authority to demonstrate that there is no public interest.

Since the launch of the second pillar of the Banking Union, there have also been cases of entities receiving public funds without even being declared as failing or likely to fail. For example, the Italian bank Monte dei Paschi di Siena benefited from 'precautionary recapitalisation'. The CMDI proposal aims to clarify the use of the precautionary recapitalisation tool in cases where the entity is clearly solvent and where the support is strictly temporary, increasing the requirements to determine from the outset the duration of the support and the exit strategy.

Entities are legally required to contribute to National Deposit Guarantee Funds (DGFs). Even so, to date, DGFs have not been able to fully realise their potential as a crisis management tool in the EU. Therefore, the CMDI reform aims to facilitate the use of DGF resources beyond their basic payout function.

The CMDI proposal has some merits in applying some of the lessons learned from past cases but falls short on a number of points. First, even if the scope of resolution is enlarged under the proposal, it still does not reflect the reality faced by the EU banking sector.

Second, with the 2013 Banking Communication not being aligned with the BRRD/Single Resolution Mechanism Regulation (SRMR), there will still be an uneven playing field in the use of public funds in resolution and liquidation. Indeed, in liquidation, the Banking Communication is applicable, allowing for the injection of public funds with a bail-in of junior debt. But in resolution, the applicable legal base is the BRRD/SRMR, which imposes a bail-in of least 8 % of the bank's equity and liabilities before recurring to the use of the Single Resolution Fund or public funds. Indeed, Banca Popolare di Vicenza and Veneto Banca were allowed to receive public funds with a bail-in solely of junior debt because they had been liquidated. Therefore, it is essential to prioritise the update of the Banking Communication and align it with the BRRD/SRMR during the review of the CMDI proposal.

Third, the SSM and other supervisors need to enforce prompt corrective action. When a bank fails to meet capital requirements, including minimum requirement for own funds and eligible liabilities (MREL), the bank and the equity holders should expect that a decision that the bank is failing or likely to fail will shortly be coming. This is the only way to put sufficient pressure on the bank to recapitalise.

Moreover, capital requirements should be upheld and preferably tightened within the scope of the Basel standards. Resolution and the corresponding MREL requirements should not justify less substantive capital requirements. Resolution is inherently a fragile concept, in particular should a systemic crisis occur. Although the CET1 ratios of European banks improved significantly in the first few years after the financial crisis, this was to a large extent driven by lower risk weights, not necessarily substantiated by lower underlying real risk. This development is reflected, inter alia, in the fairly low leverage ratios of European banks by international standards.

The EU is one of the few jurisdictions where the Basel standards have been applied to all credit institutions. Most other jurisdictions take a proportional approach and implement a simpler regime for smaller credit institutions that are not internationally active. The Basel standards have become increasingly complex, growing by a factor of close to 30 since the first set of standards. They are not designed for smaller institutions and their complexity puts pressure on them. Smaller institutions are important for the supply of credit and financial services in many local areas of the EU, and in some cases a precondition for the existence of their smaller and less centrally located communities. It is vital that these institutions are well capitalised and financially stable. If anything, a simpler framework should be a stricter framework.

5.6. A SINGLE DATA SPACE

One sector that may require more attention, from the perspectives of strategic autonomy, competitiveness and financial market efficiency, is that of financial market and ESG data. This sector is dominated by a few large players, yet attempts to bring more competition to the credit rating agency market failed after the introduction of the Credit Rating Agency Regulation in 2010. Given the EU's dominance in setting ESG standards, the Regulation on ESG rating providers and the European single access point and consolidated tape under MiFIR, consideration should be given to market developments in the market data sector to encourage new entrants. Such consideration should take into account the strong position of the European insurance sector in this domain, which has collected sustainability data for a long time.

Consequently, it may be worthwhile to better identify the ecosystem of non-financial players underlying the CMU, consisting of a few large groups (e.g. rating agencies, data providers, creators of indices and benchmarks), and engaging with them (Demarigny, 2024). These actors play a crucial role in the proper functioning of Europe's financial markets. This situation of dependence affects price formation and increases the cost of capital, which has damaging effects at the end of the chain in terms of competition, protection of investors and investment in the EU (FCA, 2024; BaFin, 2024).

The financing of the economy and the twin transition requires affordable and reliable data along with benchmarks for all participants: users, investors (households and corporates) and authorities. Both financial and ESG data are crucial for ensuring market stability, trust and transparency. They facilitate the channelling of funds into the right projects and companies. The EU has just adopted an ESG ratings regulation to strengthen the reliability and comparability of ESG ratings. It aims to improve the integrity of ESG rating providers, which will be authorised by ESMA. The regulation is an opportunity to enhance the EU's role in this domain.

A single data space raises the issue of accounting and auditing. The EU has made a strong commitment to international standards through the International Accounting Standards Regulation, mandating their use by listed corporations in the EU. However, Member States have been unable to agree on common accounting standards for other entities, especially non-listed firms operating across borders. Also, the audit profession, which inspects the financial statements of listed enterprises, is largely regulated at the Member State level. Addressing these matters could support a more integrated capital market.

An independent audit is a prerequisite for investors to trust issuers and financial instruments. Auditing nonetheless remains subject to regulation and supervision by (intrinsically fragmented) national competent authorities. This precludes the existence of an essential level playing field. Consequently, there is scope for regulatory arbitrage, which may cause differences and, in certain instances, market distortions. The EU framework for corporate governance across all sectors is limited and practices vary significantly. Some Member States have limited additional requirements for the governance of audit firms, in which the emphasis is put on the adherence of individual auditors to applicable regulations and standards. Problems may occur when foreign audit firms use the EU passport of less stringent home countries.

In trying to establish a truly pan-EU capital market, investor trust is key. If individual investors need to assess the national supervisory systems for auditors and audit firms in the home country Member State of an issuer, the system is not working and a European capital market with minimum safeguards has not been achieved. Basic requirements apply for audit engagements such that auditors can effectively start their audit engagements independent of the issuer and have access to all relevant systems and information. However, more harmonised pan-European requirements and supervision of the audit sector are required to ensure a uniform level of audit quality and governance across the single market. This would, in turn, contribute to stronger investor protection and avoid loopholes that undermine investor trust.

6. TEN RECOMMENDATIONS FOR FINANCIAL MARKETS BY 2030

Regulatory method and convergence of enforcement

1. **Emphasise enforcement through a new and enhanced structure.** With such a massive set of new rules, enforcement will be even more important, but the current structure will need to be adapted and sufficient resources will be required in terms of both quality and quantity. More rapid enforcement, involving the European supervisory authorities, could bring improvement. Today, the ESAs only have the capacity for two to three peer-reviewed actions of legislative enforcement per year. Enforcers – both national and ESAs – must prioritise the use of their resources and better equip themselves to deal with the needs of more integrated capital markets.

2. **Gradually return to principles-based legislation, take a regulatory pause and consolidate.** Level 1 legislation increasingly relies on level 2 legislation and level 3 guidelines, developed by the ESAs. Although level 2 legislation can be amended more swiftly, too many details can deter innovation, render our financial institutions less competitive and even lead some players to operate outside the EU. Furthermore, the guidelines, recommendations and Q&A nature of level 3 can introduce additional layers of complexity. The right balance should be struck between hyper-detailed and principles-based legislation. The new institutional cycle should be used by legislative bodies to progressively move back towards a more principles-based system. An initiative is needed to lengthen the periods for review clauses and to limit the resort to level 2 legislation and especially to level 3 guidelines.

Competitiveness and a level playing field

3. **Boost competitiveness through flexibility and efficiency.** So far, financial regulation has primarily focused on protecting investors/consumers and safeguarding financial stability, and less on providing the finance needed to make Europe's economies competitive. Such a shift in focus requires a financial sector that is flexible and efficient, which could be facilitated by:

   - a regulatory landscape for internationally active EU banks and other financial institutions that allows them to compete with other major non-EU institutions. In this sense, a proliferation of regulatory requirements in the financial markets, green and digital fields should be avoided and supervisory expectations set in line with what is required of other institutions at the international level;

   - proportionality for smaller banks and other financial institutions. Although the Basel principles only apply to internationally active banks, the EU extends them to all banks. The EU should avoid over-regulating and apply the principle of proportionality more consistently to smaller banks, while preserving financial stability.

4. **Level the playing field.** Consistency is far from assured. The first few years of the Single Resolution Board have produced mixed results, with some banks being resolved and others being liquidated, with substantial use of taxpayers' money. Given recent experience, the proposal on crisis management and deposit insurance should be strengthened in three ways.

   - First, the scope of resolution should be further enlarged to fully capture the reality of the EU banking sector. This calls for harmonising liquidation procedures. At the least, harmonising the most relevant aspects of the liquidation procedures should be seriously considered.

   - Second, the 2013 DG Competition Banking Communication is not aligned with the Bank Recovery and Resolution Directive or the Single Resolution Mechanism Regulation, meaning that there will still be an uneven playing field in the use of public funds for resolution and liquidation purposes. Therefore, it is essential to prioritise the update of the Banking Communication and align it with the BRRD/SRMR during the review of the CMDI.

   - Third, prompt corrective action must be enforced in order to put pressure on banks to raise capital, while the banks still have value. Waiting until their solvency falls to zero or there is a run should not be an option.

5. **Refrain from falling into fruitless political discussions.** The technical work on a European deposit insurance scheme, the third pillar of the Banking Union, has reached its limits and has been languishing on political masters' desks for almost 10 years. Yet, there is still considerable room for improvement in the integration of the EU's banking sector. Technical and political work should concentrate on matters where progress can be made.

Capital markets

6. **Unlock the power of EU savings.** More should be done to ensure that Europe is attractive to private sector capital, both domestic and international. Attempts to create a single pan-European savings product (e.g. a pan-European personal pension) have not been successful. It thus seems that the mere introduction of a new financial product will not suffice; instead, funded pension schemes should be encouraged, either through new legislation or through an agreement between unions and business associations.

7. **Avoid misguided narratives and the ensuing policy recommendations.** The Capital Markets Union was launched in 2015, after the initial success of the Banking Union. This has probably led to a misdiagnosis: it is not integration that is primarily lacking in EU capital markets, but rather development. Mislabelling could lead Europe in the wrong direction. An accurate diagnosis should come together with proper policy recommendations. In this respect, even if a reform of the EU securitisation framework could be warranted to free up banks' balance sheets and contribute to closing the EU's investment gap, it should not be depicted as one of the game-changers of the CMU project that will unlock capital markets in the EU. Subsequent reforms of the securitisation framework have been part of CMU packages and yet no relevant progress has been achieved.

8. **Adopt competition-based measures and promote passive products**. To improve investor outcomes and foster greater market efficiency, competition-driven measures should be implemented across the entire investment value chain. These measures, encompassing everything from product creation to distribution and advice, should aim to improve competition, increase fee transparency, simplify disclosures and reduce reporting burdens. Promoting passive investment products, such as index funds and ETFs, can offer cost-effective market exposure, making the investment environment more competitive and transparent, ultimately benefiting investors.

9. **Integrate the trading and post-trading market infrastructure.** Fragmentation of the trading and post-trading infrastructure is one of the defining features of EU financial markets. But compared with the US, fragmentation appears to be more acute in stock exchanges and central securities depositories. Moreover, trading venues and CSDs, just like central counterparty clearing houses, are supervised at the national level, possibly leading to an uneven playing field. In this sense, efforts should focus on creating the necessary conditions for CSDs to compete and integrate effectively, while making sure that the European Securities and Markets Authority supervises CCPs and CSDs.

Financial literacy

10. **Promote greater financial literacy to help encourage investment in a broader range of financial products, thereby contributing to the development of capital markets**. According to the June 2023 Eurobarometer, only 38 % of respondents in the EU trust the financial advice given by their bank, insurer or financial advisor. Even though the EU's competences in the field of education are limited to support and coordination, the levels of financial education in the EU Member States need significant improvement in order to achieve a genuine single market in financial services.

Financial education needs to be provided throughout life, not just during schooling but at different stages, and tailored to the typical decisions made at each life stage.

ABBREVIATIONS

AFME	Association for Financial Markets in Europe
AIFMD	Alternative Investment Fund Managers Directive
AMLA	Anti-Money Laundering Authority
AMLD	Anti-Money Laundering Directive
AMLR	Anti-Money Laundering Regulation
B2C	Business to consumer
BEFIT	Business in Europe: Framework for Income Taxation
BRRD	Bank Recovery and Resolution Directive
C2C	Customer to customer
CCP	Central counterparty clearing house
CET1	Common Equity Tier 1
CMDI	Crisis management and deposit insurance
CMU	Capital Markets Union
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSD	Central securities depository
CSDDD	Corporate Sustainability Due Diligence Directive
CSDR	Central Securities Depositories Regulation
CSRD	Corporate Sustainability Reporting Directive
DGF	Deposit Guarantee Fund
DLT	Distributed ledger technology
DORA	Digital Operational Resilience Act
EBA	European Banking Authority
EBITDA	Earnings before interest, taxes, depreciation and amortisation
ECB	European Central Bank
eIDAS	Electronic identification, authentication and trust services
EIOPA	European Insurance and Occupational Pensions Authority
ELTIF	European long-term investment fund
EMIR	European Market Infrastructure Regulation
ESA	European supervisory authority
ESG	Environmental, social and governance
ESMA	European Securities and Markets Authority
ESRS	European Sustainability Reporting Standards
FDI	Foreign direct investment

FESE	Federation of European Securities Exchanges
FICC	Fixed income, currencies and commodities
FIDA	Financial data act
FIU	Financial Intelligence Unit
FISP	Financial Information Services Providers
FSAP	Financial Services Action Plan
GNP	Gross National Product
IPO	Initial public offering
ITS	Implementing technical standards
MiCA	Markets in Crypto Assets (Regulation)
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MREL	Minimum Requirement for own funds and Eligible Liabilities
PEPP	Pan-European personal pension product
PSD	Payment Services Directive
RTS	Regulatory technical standards
SME	Small and medium-sized enterprise
SRB	Single Resolution Board
SRM	Single Resolution Mechanism
SRMR	Single Resolution Mechanism Regulation
SSM	Single Supervisory Mechanism
UCITS	Undertakings for collective investment in transferable securities

REFERENCES

AFM and DNB (2024), *Next steps for the European Capital Markets Union (CMU)*, Contribution by the Dutch Authority for the Financial Markets (AFM) and De Nederlandsche Bank (DNB), 16 February.

Aghion P. and Bolton, P. (1997), 'A theory of trickle-down growth and development', *Review of Economic Studies*, Vol. 62, No 2, pp. 151-172.

Akerlof, G. (1970), 'The market for "lemons": Quality uncertainty and the market mechanism', *Quarterly Journal of Economics*, Vol. 84, No 3, pp 488-500.

Alcidi, C., Shamsfakhr, F, Postica, D. and Gojsic, D. (2024), *Analysis of developments in EU capital flows in the global context (2023): Geo-economics and the risk of fragmentation*, CEPS Study for DG FISMA, April.

Andersson, F. and Arnal, J. (2024), *A radiography of crypto-assets and their risks*, ECRI In-depth Analysis, European Credit Research Institute and Centre for European Policy Studies, April 2024

Arcand, J.-L., Berkes, E. and Panizza, U. (2015), 'Too much finance?', *Journal of Economic Growth*, Vol. 20, No 2, pp. 105-148.

Arnal, J. (2023a), *The banking sector is increasingly looking to the cloud*, CEPS Explainer No 2023-12, Centre for European Policy Studies, 7 November.

Arnal, J. (2023b), *Why holding up the ESM Treaty's ratification is a missed risk sharing opportunity for the Banking Union*, CEPS Explainer No 2023-17, Centre for European Policy Studies, 8 December.

Arnal, J. and Andersson, F. (2024), *FiDA: is the EU prepared to move from Open Banking to Open Finance?*, ECRI Explainer, European Credit Research Institute and Centre for European Policy Studies, August 2024.

Arnal, J., Lannoo, K. and Lastra, R. (2024), *Is CMDI what the Banking Union needs?*, CEPS Policy Brief No 2024-01, Centre for European Policy Studies, 7 February.

BaFin (2024), Market study on the collection and handling of ESG data and ESG rating procedures by asset management companies, Federal Financial Supervisory Authority, March.

Bernanke, B. (1983), 'Nonmonetary effects of the financial crisis in the propagation of the Great Depression', *American Economic Review*, Vol. 73, No 3, pp. 257-276.

BCBS (2022), *High-level considerations on proportionality*, Basel Committee on Banking Supervision, Bank for International Settlements, 7 July.

Boot, A. and Thakor, A. (2000), 'Can relationship banking survive competition', *Journal of Finance*, Vol. 55, No 2, pp. 679-713.

Bordo, M. and Haubrich, J. (2010), 'Credit crises, money and contractions: An historical view', *Journal of Monetary Economics*, Vol. 57, No 1, pp. 1-18.

Borio, C. (2014), 'The financial cycle and macroeconomics: What have we learnt?', *Journal of Banking and Finance*, Vol. 45, pp. 182-198.

Brunnermeier, M. and Pedersen, L. (2009), 'Market liquidity and funding liquidity', *Review of Financial Studies*, Vol. 22, No 6, pp. 2201-2238.

Cecchetti, S. and Kharroubi, E. (2012), *Reassessing the impact of finance on growth*, BIS Working Papers No 381, Bank for International Settlements, July.

Dell'Ariccia, G., Laeven, L. and Marquez, R. (2014), 'Real interest rates, leverage, and bank risk-taking', *Journal of Economic Theory*, Vol. 149, pp. 65-99.

Demarigny, F. (2024), 'Strategic autonomy through the Capital Markets Union', Le Grand Continent, 11 January, https://legrandcontinent.eu/fr/2024/01/11/lautonomie-strategie-par-lunion-des-marches-de-capitaux/.

EBA (2023), Analysis of the EU dependence on non-EU banks and of EU banks' dependence on funding in foreign currency, European Banking Authority, October.

ECA (2022), *Investment funds: EU actions have not yet created a true single market benefiting investors*, Special Report 04/2022, European Court of Auditors, 21 February.

ECB (2024), *Financial integration and structure in the euro area*, ECB Committee on financial integration, European Central Bank, 18 June.

EFAMA (2023), *Fact Book 2023: Contents & Key Findings*, 21st Edition, Trends in European Investment Funds, European Fund and Asset Management Association.

EFAMA (2024), *The European Union must adopt a new deal to mobilise EU savings*, Market Insights, Issue 17, 20 June.

ESMA (2023a), *Peer review on supervision of CSDs providing cross–border services or participating in interoperable links*, February.

ESMA (2023b), *Supervisory briefing on the calibration of circuit breakers*, European Securities and Markets Authority, 12 October.

ESMA (2023c), *Costs and performance of EU retail investment products 2023*, ESMA Market Report, European Securities and Markets Authority, 18 December.

ESMA (2024a), *Building more effective and attractive capital markets in the EU*, Position Paper, European Securities and Markets Authority, 22 May.

ESMA (2024b), 'Composition of CCP colleges under Article 18(2) of Regulation 648/2012', European Securities and Markets Authority, 28 May.

FCA (2024), *Wholesale Data Market Study*, MS23/1.5, Financial Conduct Authority, February.

Hardie, I. and Howarth, D. (2013), *Market-based banking and the international financial crisis*, Oxford University Press.

Hughes, J. and Mester, L. (1998), 'Bank capitalization and cost: Evidence of scale economies in risk management and signaling', *Review of Economics and Statistics*, Vol. 80, No 2, pp. 314-325.

Kaserer, C. and Trebel, V. (2024), 'The EU prospectus regulation and its impact on SME listings', *Journal of International Financial Markets*, Vol. 93, pp. 1-22.

Kiyotaki, N. and Moore, J. (1997), 'Credit cycles', *Journal of Political Economy*, Vol. 105, No 2, pp. 211-248.

Krugman, P. (1994), 'Competitiveness: A dangerous obsession', *Foreign Affairs*, Vol. 72, No 2, pp. 28-44.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R. (1998), 'Law and Finance', *Journal of Political Economy*, Vol. 106, No 6, pp. 1113-1155.

Langfield, S. and Pagano, M. (2015), Bank bias in Europe: effects on systemic risk and growth, ECB Working Paper No 1797, European Central Bank, 28 May.

Lannoo, K. (2007), *MiFID: A regulatory doomsday?*, CEPS Commentary, Centre for European Policy Studies, 20 January.

Lannoo, K. (2019), *Ceci n'est pas un PEPP*, ECMI Commentary No 60, European Capital Markets Institute, 7 May.

Lannoo, K. (2023a), *Bank stress tests lift only a tip of the veil*, ECMI Commentary No 85, European Capital Markets Institute, 29 August.

Lannoo, K. (2023b), 'Plus ça change, moins ça change' pour la City de Londres, Quelle Europe financière demain', Revue Banque, 6 November.

Letta, E. (2024), *Much more than a market – Speed, security, solidarity: Empowering the Single Market to deliver a sustainable future and prosperity for all EU Citizens*, 18 April.

McKinsey & Company (2021), *European asset management after an unprecedented year*, 4 July.

Minsky, H. (1986), *Stabilizing an unstable economy*, McGraw Hill.

Moloney, N. (2018), *The Age of ESMA: Governing EU financial markets*, Bloomsbury Publishing.

Morningstar (2024), '2023 US fund fee study', Manager Research, July.

Navid, Kian (2023), 'How many Single Rulebooks? The EU's post-crisis policy objective to create a Single Rulebook for investment management', PhD Thesis, Maastricht University.

Noyer, C. (2024), *Developing European capital markets to finance the future*: Proposals for a Savings and Investments Union, 25 April.

Oliver Wyman and EBF (2023), *The EU banking regulatory framework and its impact on banks and the economy*, Reference Study, 27 January.

Pagano, M. and Volpin, P. (2005), 'The political economy of corporate governance', *American Economic Review*, Vol. 95, No 4, pp. 1005-1030.

Pagano, M., Langfield, S., Acharya, V., Boot, A., Brunnermeier, M., Buch, C., Hellwig, M., Sapir, A. and van den Burg, I. (2014), *Is Europe overbanked?*, Report of the Advisory Scientific Committee No 4, European Systemic Risk Board, June.

Pelkmans, J. (2024), *Empowering the single market: A 10-point plan to revive and deepen it*, CEPS In-Depth Analysis No 2024-03, Centre for European Policy Studies, 30 January.

Reinhart, C. and Rogoff, K. (2009), *This time is different: Eight centuries of financial folly*, Princeton University Press.

Restoy, F. (2019), *Proportionality in financial regulation: where do we go from here?*, Speech at the BIS/IMF policy implementation meeting on proportionality in financial regulation and supervision, 8 May.

Scope Group (2024), *A new era: Overview of the ELTIF market 2023/2024*, 15 May.

TheCityUK (2024), *Advancing international competitiveness and economic growth: how do financial regulators compare*, April.

Thomadakis, A., Lannoo, K. and Moloney, N. (2022), *Time to re-energise the EU's capital markets – Building investable and competitive ecosystems*, CEPS-ECMI Study, Centre for European Policy Studies, 30 November.

Thomadakis, A. (2023a), *The collapse of SVB: A mix of poor risk management and regulatory failure*, ECMI Commentary No 81, European Capital Markets Institute, 27 March.

Thomadakis, A. (2023b), *SVB and Credit Suisse: When rules yield, it is time to change the system*, ECMI Commentary No 83, European Capital Markets Institute, 1 June.

Thomadakis, A. and Arnal, J. (2024), 'Ten years of the Single Supervisory Mechanism: Looking into the past, navigating into the future', *Journal of Financial* Regulation, fjae005, https://doi.org/10.1093/jfr/fjae005.

Thruchet, M. (2022), *Capital Markets Union: where are we?*, Eurofi Regulatory Update, February.

Wheelock, D. and Wilson, P. (2012), 'Do large banks have lower costs? New estimates of returns to scale for U.S. banks', *Journal of Money, Credit and Banking*, Vol. 44, No 1, pp. 171-199.

APPENDIX A. MEMBERS OF THE TASK FORCE[15]

CHAIR

Jesper Berg, Former Director-General, Danish Financial Supervisory Authority

MEMBERS

Arampatzi, Alexia, Senior Economist, ECB

Armesto Plaja, Rosa, Director-General, FESE

Bakay, Zoltan, Senior Research Expert, Erste Group

Baltzersen, Morten, Counsellor for Finance, Mission of Norway to the EU

Bank, Zelda, Policy Advisor, EU Liaison Office, Deutsches Aktieninstitut e.V.

Barros, Johan, Head of Policy and Advocacy, Accountancy Europe

Bertoncello, Nicolo, Parliamentary Assistant, European Parliament

Collier, Nick, Managing Director of the Brussels Office, City of London

Commain, Sébastien, Research and Policy Officer, Better Finance

Cunningham, James, Senior Advisor, BNY Mellon

de Miguel, David, Deputy Director, Policy and Innovation, Spanish Securities and Exchange Commission

Del Signore, Francesco, Senior Regulatory Advisor, Intesa Sanpaolo

Di Lupidio, Benedetta, Team Leader, Institutional Relations and Strategy, EIOPA

Durand, Louis-Marie, Director, EU and International Public Affairs, AFG

Eard, Arnaud, Director, EU and International Affairs, AMAFI

Everts, Gerben, Director of VEB

Fox, Brian, Executive Director, JP Morgan

Garcia del Riego, Antonio, Member, EESC

Hübner, Danuta, Former MEP and Member of CEPS Board

Kamerling, Josina, Head of Regulatory Outreach, EMEA, CFA Institute

Kanelli, Eleni, Director, Strategy Coordination & Political Affairs, Accountancy Europe

[15] The report was drafted by the rapporteurs of the Task Force. Its recommendations do not necessarily reflect a common position reached or endorsement by all members, nor do they represent, in any manner, the views of the institutions to which the members belong.

Kireche, Remi, Director, Advocacy, AFME

Kisselevsky, Boris, Head of the ECB Representation in Brussels, ECB

Klec, Gerald, Administrator, EESC

Lamandini, Marco, Professor of Commercial Law, University of Bologna and Member of the ECMI Academic Committee

Lopez de Silanes, Florencio, Professor of Finance, SKEMA Business School and Member of the ECMI Academic Committee

Lowet, Lieve, Independent Consultant, Schuman European Affairs

Mills, Jacqueline, Head of Advocacy, AFME

Moens, Jan, Parliamentary Assistant, European Parliament

Moloney, Niamh, Professor of European Capital Markets Law, LSE and Member of the ECMI Academic Committee

Mongelli, Francesco Paolo, Senior Advisor, ECB

Munafo, Pasquale, International Relations Officer, CONSOB

Nagtegaal, Jelmer, Research Fellow, CEPS

Neves, Pedro, Advisor to the Board, Banco de Portugal

Peeters, Ilse, Director, Head of Government Relations and Public Affairs, Euroclear

Portugal, Pablo, Senior Public Affairs Director, Euroclear

Postius, David, EU Policy Manager, Banco Santander

Prache, Guillaume, Senior Advisor, Better Finance

Riess, Rainer, Senior Advisor, FESE

Rodkiewicz, Julia, Director, Market Practice and Regulatory Policy, ICMA

Schou, Anders, Economic Executive Director, Finans Denmark

Siri, Michele, Professor of Capital Market Law, University of Genoa and President, ESA's Joint Board of Appeal

Spendzharova, Aneta, Associate Professor, University of Maastricht

Tambucci, Martina, Head, International Relations Office, CONSOB

Teeboom, Piebe, Secretary-General, EPTA

von Sicard, Mette, Senior Advisor, Danmarks Nationalbank

RAPPORTEURS

Arnal, Judith, Senior Research Fellow, CEPS and ECRI

Lannoo, Karel, CEO, CEPS and General Manager, ECMI and ECRI

Thomadakis, Apostolos, Research Fellow, CEPS and Head of Research, ECMI

APPENDIX B. TASK FORCE MEETINGS AND SPEAKERS

1. First meeting – Kick-off of the Task Force (4.10.2023)

   - John Berrigan, Director-General, DG FISMA
   - Judith Arnal, Senior Research Fellow, the Elcano Royal Institute and Independent Board Member, Bank of Spain
   - Pedro Neves, Advisor to the Board, Bank of Portugal
   - Kian Navid, Senior Policy Officer, Investment Management Unit, Investor Protection and Sustainable Finance Department, ESMA

2. Second meeting – Supervisory priorities (14.12.2023)

   - Petra Hielkema, Chairperson, EIOPA
   - Niamh Moloney, Professor of European Capital Markets Law, LSE and Member of the ECMI Academic Committee, LSE Law School

3. Third meeting – Priorities for the next cycle (18.3.2024)

   - Jacob Gyntelberg, Director, Economic and Risk Analysis, European Banking Authority
   - Andrea Beltramello, Head of Unit, DG FISMA, European Commission

4. Fourth meeting – Reflections on the Capital Markets Union (30.4.2024)

   - Ugo Bassi, Director, Financial Markets, DG FISMA, European Commission
   - Alain Deckers, Head of the Asset Management Unit, DG FISMA, European Commission
   - Niamh Moloney, Professor of European Capital Markets Law, LSE

5. Fifth meeting – Feedback on the first draft of the Final Report (26.6.2024)

APPENDIX C. RECENT REPORTS AND POLITICAL STATEMENTS

Statement by the ECB Governing Council on advancing the Capital Markets Union

On 7 March 2024, the ECB Governing Council published a statement on advancing the Capital Markets Union (CMU)h. It calls for further progress, in order to:

- ensure that the EU securitisation market can play a role in transferring risks away from banks and enable them to provide more financing to the real economy;
- integrate the supervision of EU capital markets by ensuring that the European Securities and Markets Authorities (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA) have European and independent governance, sufficient resources and comprehensive oversight powers, directly supervising the most systemic entities in the cross-border capital market;
- promote a targeted harmonisation of corporate insolvency rules, accounting frameworks and securities laws;
- finalise harmonisation of the processing of withholding tax and corporate actions, while overcoming the remaining integration barriers in securities post-trade services (including collateral management);
- address the debt bias in taxation.

Furthermore, the Eurosystem will continue to contribute significantly to the CMU in the area of financial market infrastructure by:

- exploring, together with financial market stakeholders, the potential use of new technologies for issuance, trading and settlement, promoting tokenisation and possibly a 'European unified ledger';
- supporting the development and integration of pan-European financial market infrastructure to provide European financial markets with a single pool of euro liquidity in central bank money;
- catalysing and coordinating market efforts to implement a single pan-European rulebook for securities settlement and collateral management (including the harmonisation of debt-issuance procedures);
- supporting and monitoring industry efforts to build up further central clearing capacity within the EU.

In terms of listings, the EU should harmonise the listing requirements and consolidate stock exchanges and market infrastructure, while supporting large EU-based institutional investors.

To enable households and individuals to reap the benefits of the CMU, the proposed non-legislative initiatives on financial education should continue to be considered important and prioritised by Member States. Although the full impact of the benefits from such actions might only appear in the medium to long term, other initiatives, for instance on pension savings options or advice, could yield quicker benefits.

Statement of the Eurogroup on the future of the Capital Markets Union

On 11 March 2024, the Eurogroup in its inclusive format agreed on the priority areas for action and measures for the future of the CMU. The priority areas identified for action are architecture, business and citizens (ABC). Under each of these priority areas, a set of measures are specified.

Under architecture, the first proposed measure intends to develop the EU securitisation market to allow for the efficient and transparent transfer of risk to those best equipped to carry it. The Eurogroup calls for convergence in the supervision of capital markets across the EU, as well as for reductions of the regulatory burden and transaction costs for market participants. Convergence of national corporate insolvency frameworks, accounting frameworks and listing requirements across European exchanges would increase the attractiveness of capital market finance for companies. Last but not least, there is a need to foster equity financing through well-designed national systems for corporate tax to ensure EU companies have access to diversified sources of funding.

Moving on to business, the aim is to improve conditions for institutional, retail and cross-border investment in equity, in particular in growth/scale-up venture capital through regulatory means, targeted tax incentives by Member States or other measures at the EU and national levels. On top of that, the EU should expand its leadership in sustainable finance by enhancing the effectiveness of the existing EU framework and encouraging market participants to utilise the provided finance toolkit to support their transition efforts.

Finally, to facilitate citizens' access to capital markets, the Eurogroup calls for the creation of an attractive, easy-to-use and consumer-centric investment environment, including accessible and secure digital interfaces developed by the industry. Efforts should also focus on supporting sufficient complementary income streams for an ageing population through wider use of longer-term savings and investment products, including through occupational and personal pension schemes. To achieve all these aims, it is not only necessary to develop and offer attractive, cost-effective and simple cross-border investment/savings products to retail investors, but more importantly, to also cultivate an investor/shareholder culture among the EU public.

The Letta Report

Former Italian Prime Minister Enrico Letta was tasked by the European Council with producing an independent High-Level Report on the future of the Single Market. The final output presents an in-depth analysis with recommendations for deepening the single market and as such, devotes a single chapter to financial issues.

The Letta Report (2024) advocates for the creation of a 'Savings and Investments Union', requiring urgent progress in three structural areas: (i) the supply of capital, (ii) the demand for capital, and (iii) the institutional framework and market structure governing the movement of that capital. Based on this philosophy, the report gives a set of policy recommendations.

Focusing on institutional investors, particularly pension funds, the report suggests creating an auto-enrolment EU long-term savings product and simplifying and upgrading the pan-European Personal Pension Product (PEPP). The report also notes that the total financial assets of insurance companies in the euro area significantly exceed those of pension funds. Therefore, it recommends improving coherence among Member State frameworks for approving internal models used to calculate capital requirements for large insurance groups and establishing joint supervisory teams with the relevant European national supervisors and EIOPA.

Regarding retail savings, the report emphasises the importance of enhancing financial literacy, establishing a harmonised European framework for recognising qualified investors and integrating national tax incentives with the European Long-Term Investment Fund (ELTIF).

Financing the green transition is identified as a top priority, with banks requiring public support. To address this, Letta calls for the introduction of a specific European Green Guarantee. The European Commission and the European Investment Bank should develop a framework and secure financial resources to support bank lending to green investment projects and companies. Additionally, revisiting the regulatory framework for securitisation is recommended to further support bank lending.

In terms of capital markets, the report suggests creating a single point of entry to public capital markets for small and mid-cap companies to facilitate market access for SMEs. Collaboration should be encouraged among key EU stock exchanges to pool their small and mid-sized segments. This initiative should be accompanied by campaigns to raise awareness about the benefits and risks of capital markets. Furthermore, there is a proposal for the establishment of an EU deep tech stock exchange with specific rules and supervision, as current national regulations and oversight are not well-suited for deep tech stocks, which are typically evaluated based on revenues and profits similar to traditional industries.

From an institutional standpoint, the report emphasises the need to strengthen ESMA by gradually extending its direct supervisory powers and bolstering its Management Board. This should be accompanied by efforts to harmonise the interpretation of rules and standards as well as insolvency regimes, and to address barriers in the post-trading landscape. Financially, Letta recommends introducing single benchmarks for European financial markets by marketing existing and future EU issuances under a single name, backed by their respective credit and capital structures. Additionally, there is strong support for the introduction of a digital euro to prevent the marginalisation of European banks by new players in the global payment market and to maintain their competitiveness.

European Council Conclusions on the Capital Markets Union

A significant portion of the European Council Conclusions from 17 and 18 April 2024 focused on advancing the CMU. The European Council emphasised the need for urgent progress on several key measures:

- harmonising relevant aspects of national corporate-insolvency frameworks;
- fostering investments, including in cross-border equity, through targeted convergence of well-designed corporate systems for capital market players and mechanisms;
- relaunching the European securitisation market through regulatory and prudential changes;
- improving the convergence and efficiency of capital market supervision across the EU.

Additionally, the European Council highlighted the importance of improving conditions for institutional, retail and cross-border investment in equity, as well as financing and exit options for European scale-ups. Other priorities include ensuring a level playing field in access to private capital in all Member States, designing and implementing a simple and effective cross-border investment/savings product for retail investors, developing pensions and long-term savings products, and creating an attractive, consumer-friendly investment environment. This includes promoting an investor culture among the EU public by improving financial literacy and raising awareness, as well as reviewing and simplifying the framework for financial market regulation to reduce red tape.

The Noyer Report

In January 2024, French Finance Minister Bruno Le Maire appointed a committee of experts, chaired by Christian Noyer, to develop concrete proposals for revitalising the CMU to meet the EU's growing investment needs. In April 2024, the committee presented its report offering a comprehensive diagnosis and four key recommendations for: (i) developing European long-term savings products, (ii) revitalising securitisation markets, (iii) moving towards integrated supervision of capital market activities, and (iv) considering ambitious measures to address the fragmentation of settlement systems.

The report begins with the development of European long-term savings products, acknowledging the failure of the PEPP. It highlights the proliferation of existing products and the specificity of national frameworks. Consequently, Noyer proposes an intergovernmental approach to create a new class of European savings products under a unified label. Willing Member States could either adapt some of their existing domestic products or introduce new ones.

Regarding securitisation, the report identifies two main priorities. The first priority is to adjust the regulatory and prudential framework to transform insurers' asset allocations. This involves reducing capital charges, particularly for non-senior STS (simple, transparent and standardised) tranches. It also entails enabling a more granular risk assessment by segmenting the non-STS category into senior and junior subcategories and creating a new mezzanine tranche for STS securitisation. The second priority is to simplify the transparency rules to facilitate the issuance and acquisition of securitised assets.

In terms of supervision, the Noyer (2024) report advocates for a comprehensive review of ESMA's governance to make it more autonomous from the Board of Supervisors in individual decision-making. By adopting a governance model similar to that of Anti-Money Laundering Authority or the Single Supervisory Mechanism, ESMA would establish a stronger central decision-making body, an executive board, composed of a chair and five additional members. The report suggests expanding ESMA's supervisory powers depending on the actors and markets involved:

- post-market infrastructure, i.e. central counterparty clearing houses and central securities depositories (CSDs) would be mandatorily supervised by ESMA;
- trading venues of a European scale (e.g. Euronext or Nasdaq Nordics) would also fall under ESMA's supervision;
- asset managers seeking more integrated supervision could opt for direct oversight by ESMA;
- distributed products, particularly investment funds specified in European law (e.g. ELTIFs or UCITS), could also be included in this integrated supervision regime.

Finally, the report acknowledges that European financial markets suffer from a high degree of settlement-delivery fragmentation. While the trading of financial instruments takes place on a multitude of trading platforms in both the US and the EU, the landscape of post-trade infrastructure in the EU is particularly fragmented. It is suggested that TARGET2-Securities should be allowed to perform other functions traditionally offered by CSDs, by deleting in the bylaws the principle according to which TARGET2-Securities cannot legally become a CSD. This should be accompanied by a convergence of securities laws undertaken within the EU. In the longer term, a blockchain-operated settlement and delivery service by TARGET2-Securities should be worked out.

PRINCIPLES AND GUIDELINES FOR THE TASK FORCE

Task Forces are processes of structured dialogue among national and EU policymakers, industry representatives, practitioners and civil society actors/NGOs, who are brought together over several meetings. Task Force Reports are the final output of the discussions and the research carried out independently by CEPS in the context of the Task Force. Task Forces are organised and implemented in full compliance with the CEPS Integrity Statement.

Participants in a Task Force

- Rapporteurs are CEPS and external researchers/academics who organise and implement the Task Force, conduct the research independently and draft the Final Report.
- Participants can include for-profit entities, membership organisations, NGOs and scholars. This ensures that discussions are balanced and evidence-based, making the modus operandi and final output truly multi-stakeholder. Observers are policymakers or key stakeholders who are invited to attend the Task Force meetings and provide oral and written input.

Objectives of a Task Force report

- Task Force reports are meant to contribute to policy debates by presenting a balanced set of arguments, based on the Task Force discussions, available data and literature as well as qualitative research.
- Reports seek to provide readers with a constructive and critical basis for discussion. Conversely, they do not seek to advance a single position or misrepresent the complexity of any subject matter. Task Force reports also fulfil an educational purpose and are therefore drafted in a manner that is easy to understand.

The role of the Task Force participants

- Participants’ contributions may take the form of participation in informal debates or formal presentations during the meetings, or a written submission. Participants are given opportunities to provide observations on the Task Force report before it is published, as detailed below.

Drafting of the Final Report and Recommendations

- The Final Report is drafted in accordance with the highest integrity and scientific standards.
- Task Force participants are invited to comment and send their observations on the draft version(s) of the report. Task Force reports feature a set of key findings and conclusions. To draft these conclusions, rapporteurs mainly consider the research findings and consider members' evidence-based views. Task Force reports feature a set of policy recommendations. Task Force participants are not expected to endorse these recommendations.
- The overall content of the report remains the sole responsibility of the rapporteurs, and its content may only be attributed to them and not their own institutions or the Task Force participants.

Centre for European Policy Studies

CEPS is one of Europe's leading think tanks and forums for debate on EU affairs, with an exceptionally strong in-house research capacity and an extensive network of partner institutes. CEPS is committed to carrying out state-of-the-art policy research that addresses the challenges facing Europe and maintaining high standards of academic excellence and unqualified independence and impartiality. It provides a forum for discussion among all stakeholders in the European policy process and works to build collaborative networks of researchers, policymakers and business representatives across Europe.

European Capital Markets Institute

ECMI conducts in-depth research aimed at informing the debate and policymaking process on a broad range of issues related to capital markets. Through its various activities, ECMI facilitates interaction among market participants, policymakers, supervisors and academics. These exchanges result in commentaries, policy briefs, working papers and task forces as well as conferences, workshops and seminars. In addition, ECMI undertakes studies externally commissioned by the EU institutions and other organisations, and publishes contributions from high-profile guest authors.

European Credit Research Institute

ECRI is an independent, non-profit research institute that develops its expertise from an interdisciplinary team and networks of academic cooperation partners. ECRI provides in-depth analysis and insight into the structure, evolution and regulation of retail financial services markets in Europe. Through its research activities, publications and conferences, ECRI is engaged on a variety of topics in the area of retail financial services at the European level, such as consumer credit and housing loans, credit reporting, consumer protection and electronic payments. ECRI also provides a venue for its members to participate in the EU-level policy discussion.

Place du Congrès 1
1000-B Brussels
Belgium