



Which Union for Europe's Capital Markets?

Karel Lannoo

The call for a Capital Markets Union has been a useful device to raise awareness about the need for more integration in Europe's capital markets. Despite years of harmonising regulation and a single currency, Europe's capital markets remain fragmented. This Policy Brief calls for targeted measures to overcome fragmentation, through enhanced enforcement, strengthening of the European supervisory authorities, enhanced disclosure and comparability of financial information and the mobilisation savings in EU-wide investment funds.

The prospect of Capital Markets Union has raised expectations across the board. For some, it holds out the promise of easing access to finance for SMEs in Europe's bank-dominated financial model. For others, it would help overcome fragmentation in Europe's capital markets and thereby create scale and depth. For still others, it would provide harmonising elements that have not yet been addressed at EU level, such as for securitisation. And finally, some view it as a vehicle for creating a European SEC for securities markets, which would perform an analogous role to that of the ECB for banking union.

The debate about integrating Europe's capital markets is not new, far from it. The first attempt dates back to the early 1980s with the harmonisation of public offerings and listing particulars. A second wave followed with the 1992 programme and the agreement on the Investment Services Directive (ISD). By the end of the 1990s, in the wake of EMU, a new wave of harmonising measures was proposed under the aegis of the Financial Services Action Plan (FSAP), with the ambition to increase growth and reduce funding costs. The centrepiece was the 2004 Markets in Financial Instruments Directive (MiFID), but it also contained measures regulating disclosure and market manipulation. The financial and sovereign crises have led to the latest wave of measures, with EMIR (European Market Infrastructure Regulation) and an upgrade of MiFID, inter alia.

But despite years of harmonising regulation and a single currency, Europe's capital markets remain fragmented. Many market operators continue to be vertically integrated, few new EU-wide structures have emerged over the last decade and the most powerful intermediaries are often of US parentage. Europe has struggled for years to create a decent capital market as an alternative to the dominant model of bank financing, but the financial crisis has impoverished and re-fragmented the landscape. This led the President of the European Commission to call for Capital Markets Union, as part of his priorities for the next five years, in his maiden speech to the European Parliament on 16 July 2014.

This paper aims to help to focus the debate. It starts with a discussion of the essential components of capital markets. A second section compares the size of the different segments of capital markets in the EU and its member states with other countries, mostly the US. A third section looks at efficiency indicators of capital markets and the cost of fragmentation. A fourth section discusses some policy priorities. We draw heavily on the extensive work undertaken by both CEPS and ECMI on this subject since the mid-1990s. Some notable titles include: Capital Markets and EMU (CEPS Task Force, Chair Tommaso Padoa-Schioppa, 1999), Does Europe Need an SEC? (ECMI Occasional Paper, 2001), Europe's Hidden Capital Markets (CEPS Task Force Report, 2005), MiFID 2.0 (CEPS-ECMI Task Force Report, 2011).

Karel Lannoo is Chief Executive Officer of CEPS. This paper was discussed in a meeting of the Financial Services Committee of the EU Council, on 11 February 2015. The text benefitted from earlier discussions with CEPS and ECMI members at the ECMI Annual Conference, 29 October 2014 and in the European Capital Markets Expert Group (ECMEG), which was launched in December 2014. Comments from CEPS colleagues are also gratefully acknowledged.

Papers in the ECMI Policy Brief series provide insights into regulatory initiatives that affect the European financial landscape. They are produced by specialists associated with the European Capital Markets Institute, which is managed and staffed by the Centre for European Policy Studies (CEPS) in Brussels. Unless otherwise indicated, the views expressed are attributable only to the authors in a personal capacity and not to any institution with which they are associated.

1. What is a capital market?

A capital market is easy to define but harder to implement – a challenge that the EU itself has also experienced over the last 20 years. Compared to bank-based finance, it is much more difficult to put in place, as it requires a very complex and developed structure to function efficiently. One could even argue that a well-functioning model of a capital market is hard to ‘export’. No wonder that there are few developed and well-functioning capital markets in the world. Regulation and self-regulation have a central role in allowing markets to function well, which allows the best regulated market to have the lowest cost of capital.

A capital market works as a conduit for the demand and supply of debt and equity securities. It channels money provided by investors and banks to borrowers through a variety of instruments, called securities. A capital market is not a compact unit, but a system with differing degrees of centralisation. In most countries, the stock market is centralised, although in the most developed markets, fragmentation has grown between different trading platforms as a result of deregulation. Bond and derivative markets were highly decentralised, or functioned under different models – mostly bilateral or sometimes centralised in certain segments – but a process towards centralisation is ongoing as a result of the financial crisis.

A central problem, analysed at length in the literature, is the information asymmetry between issuers and investors. Thus, in order to ensure equity and efficiency of securities markets, (self-)regulation must ensure that a sufficient amount of credible information is delivered equally to investors, and that issuers receive a correct price for their securities. Much of the debate has focused on how to make disclosure by issuers work, and on the transparency of the price formation in ‘organised markets’.

The implementation and enforcement of this process depend on a complex set of institutions. Not only do government bodies play a role, but also self-regulatory organisations and ‘reputational intermediaries’ (Black, 2000). Stock exchanges, investment banks, law firms and audit firms put their name at stake when participating in an initial public offering (IPO) in disseminating information on securities issuers and listed enterprises. They will suffer a loss of reputation or even counter-claims if they support a bad security on the market. A second tier of intermediaries consists of investment and pension funds (also called the ‘buy side’), which create market demand for securities. The financial press acts as opinion-shapers and data providers, as repositories of information. The intermediaries are controlled by government and/or self-regulatory organisations (SROs). The latter can be subdivided into voluntary (professional organisations)

and mandatory (SROs mandated and controlled by government) organisations. Intermediaries are liable by law for faulty information. Table 1 presents this structure schematically.

Table 1. The different layers of securities markets

1. Issuers	Equity and debt securities
2. Infrastructure	Securities exchanges, settlement organisation, central counterparties
3. Reputational intermediaries	- Investment banks, brokers, analysts, auditors, law firms and rating agents - Institutional investors (investment funds, pension funds, insurance companies) - Financial press, data providers
4. Self-regulatory organisations	- Professional federations (analysts) - Standard setters (i.e. accounting, audit)
5. Government institutions	- Securities, futures and commodities authorities - Conduct authorities - Courts
6. Laws	Securities law Company law Consumer law

This structure is highly complex and will require years before it can be put in place and becomes fully functioning. It requires the different layers of institutions to work efficiently. Bad functioning by one element of a layer affects the whole chain. Formal rules are only a start. Next comes the institutions and enforcement, which is the “more difficult task”, including direct public enforcement and indirect enforcement through the reputational intermediaries (Black, 2000, p. 17).

Compared to the US, which has a long history of securities market regulation and two specialised federal securities markets supervisors, Europe has gone through different waves of harmonisation over the last two decades, but apparently not yet with convincing success, given the continued need for capital markets union. However, when compared to the early 1990s, Europe has come a long way, but it is a good example of the complexity of building a set of institutions to support securities markets. By the end of 1993, with the launch of the single market and the coming into force of the Investment Services Directive (ISD), the first real piece of harmonising legislation, the member states of the EU had a domestic stock market capitalisation of only 43% of GDP, in contrast to 77% in Japan and 85% in the US (NYSE and NASDAQ). Excluding the UK, the average stock market capitalisation in the EU amounted to 31% of GDP. Countries such as Austria, Germany or Italy hardly had a stock market worthy of the name, with a capitalisation of around 20% of GDP. The second set of policy initiative followed in the wake of the start of EMU and the dot.com bubble with the Financial

Services Action Plan (2001), culminating in the adoption of MiFID, which came into force at the end of the most recent bubble.

For emerging markets to create capital markets from scratch represents an even more complex task, which explains why it is easier to develop bank-intermediated financing in the first place, requiring as it does a much less complicated institutional and regulatory set-up. But a capital markets model also implies that there is a huge task in educating issuers and investors in capital markets about their rights and obligations.

Black (2000) sees limited room for 'piggy-backing' on the reputation of foreign countries. The whole set-up is difficult to transpose, in as much as the functioning and reputation of the entire structure comes into play. The best-run system will have the cheapest costs for raising capital. Regulatory competition should thus increase standards. Other scholars came to the same conclusion (see e.g. Romano, 2001, and also Lannoo & Khachatryan, 2003, for an overview). Opponents of regulatory competition argue that markets may not be able to properly differentiate between efficient and inefficient firms and thereby fail to prevent the resources from ending up in the 'lemons' market, following Akerlof (1970). This may, at EU level, point

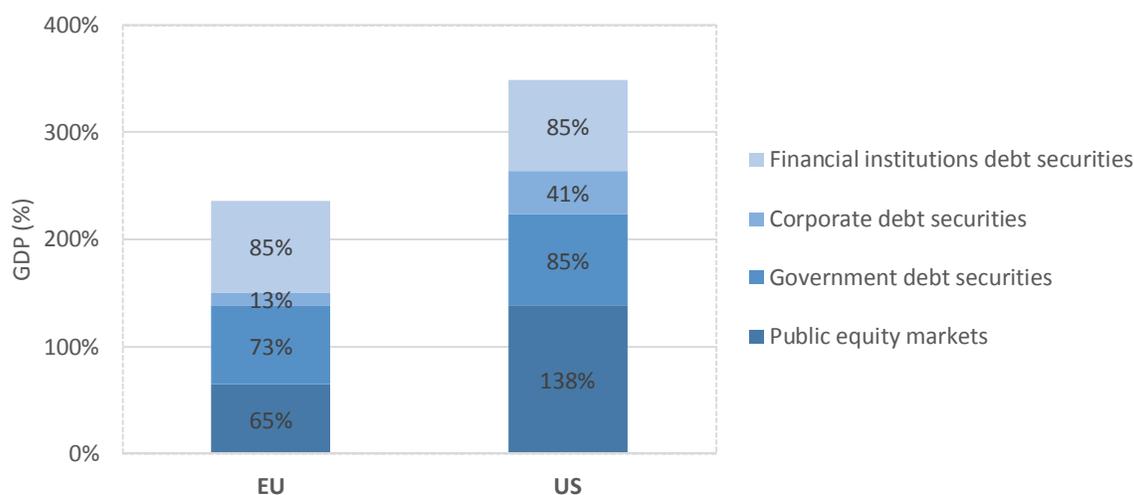
to the need for a stricter enforcement mechanism of securities law, analogous with Banking Union, as the illusion of a common standard would put the best-run markets at a disadvantage.

2. How do capital markets and its segments compare?

The benchmark for capital markets is the US, which has the depth, scale and breath, also for foreign issuers. Comparisons can be made for the EU as a bloc, although a comparison by member state may give an entirely different perspective. Many EU member states have developed their markets to a greater extent than suggested by the historical data mentioned above. But important differences remain between markets that are mostly of a structural nature, and that will hamper the development of a Union for capital markets.

Adding up the different components of the core equity and debt securities markets, the EU is about one-third smaller than the US market (end-2013). Government and financial debt securities are comparable in relative size, but the big difference lies with the securities markets for corporations, in which corporate equity and debt securities are twice or more the size than in the EU.

Figure 1. Capital markets structure – EU vs US (end December 2013)

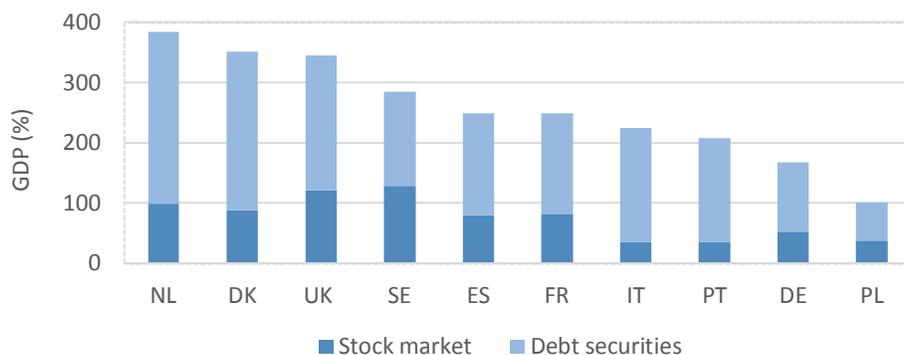


Source: ECMI Statistical Package (2014).

Looking at the situation in individual member states reveals important differences. In fact, there is hardly an EU model for securities markets, but rather an enormous diversity of models. The indebtedness of the sovereign can explain one element in the development

of debt securities markets, but not everything. Germany has an underdeveloped market on all accounts, whereas the Netherlands and Denmark have debt securities markets that equal almost three times the national GDP.

Figure 2. Stock market capitalisation and outstanding debt securities (end December, 2013)



Source: ECMI Statistical Package (2014).

The data demonstrate that capital markets in some countries are well developed and can, for example, respond to the financing needs of SMEs or infrastructure. In other cases, an equity market is still emerging, and the debt market is dominated by the sovereign's needs. But it also seems to indicate that there is limited integration amongst the capital markets of the EU member states. Several local factors seem to hamper cross-border provision of capital market products or prevent competition at EU level.

The degree of integration, or the remaining fragmentation of EU capital markets can be monitored in several ways. On an aggregate basis, the ECB has tracked integration of EU financial markets over a long period of time, using composite price-based and quantity-based indicators, and based on a theoretical benchmark of a fully integrated market (SYNFINT). According to the latest update, published in April 2014, the price-based indicator shows that market integration has declined significantly since the peak of 2007, and is now at the level of 1999, or the start of EMU (ECB, 2014). This means that dispersion among a set of indicators covering money, bond, equity and banking markets increased markedly with the financial crisis, and is now at the same level as 15 years ago. The quantity-based indicator, covering cross-border holdings of banks (MFIs) with regard to four market segments – government and corporate bonds, equity and interbank lending – also declined back to the level of 1999. The latter indicator shows that at the peak, the government and corporate bonds were the most integrated, followed by interbank lending, whereas equity markets remained significantly less integrated.¹

3. Efficiency indicators of capital markets and operators

Fragmentation can also be measured by comparing price and size indicators, taking the US as the benchmark of a more integrated market. General size indicators were already given before, but the structural differences between both markets have to be taken into account. On the basis of a variety of indicators, a highly diverse picture emerges, with the EU, or some of its member states, doing better than the US in some areas, whereas the opposite is the case in others. In many of these cases, regulation, or the lack of it, is key in explaining the differences. We start with the core components of securities markets, followed by capital market products and intermediaries.

In the domain of equity trading, EU markets are very competitive, and are trading at bid-ask spreads for the 'blue chip' stocks that are comparable or even better than those offered on US markets. As a proxy for the competitiveness of securities markets, bid-ask spreads narrowed significantly in the EU as a result of a 20-year process of liberalisation, starting with the EU's Investment Services Directive in 1994. It encouraged EU exchanges to invest in electronic trading platforms, at a time when the US market was still largely floor-driven. This happened even if the markets remained physically fragmented, i.e. the different markets continued to operate in different financial centres but were virtually one (see Valiante, 2011, p. 33).

The same is not true for the debt markets, where large bid-ask spreads continue to apply in secondary markets, notwithstanding many commitments from industry to improve practices. It is now up to the implementation of the amendments to the Markets in Financial Instruments Directive (MiFID II) to bring much needed transparency to bond markets. Until today, transparency was not required, and the market remained largely in the hands of the wholesale operators, with a few exceptions. In the US, by comparison, the authorities imposed a trade-reporting

¹ See presentation by Mauro Grande (ECB, 2014) on the occasion of the launch of the 2014 report (www.ecb.europa.eu/events/conferences/shared/pdf/finintrep_pres.pdf?fc499fd5f7b9672e75e92b80240d915d).

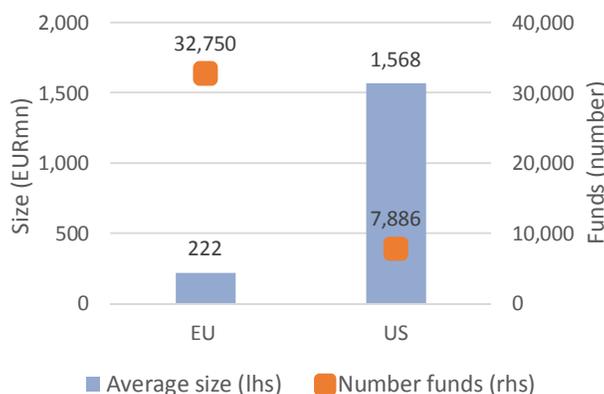
engine (called TRACE) also for corporate bond markets.

The fact that overall trading costs continue to diverge is related to settlement costs, an element of the market that was not opened-up to competition, until recently. Even if trading is competitive in the EU, the costly settlement of trades make it less attractive, as competition among central securities depositories (CSDs) was not opened-up. But this situation should change now with the CSD Regulation and the arrival of Target 2 securities. In this domain, as in bond market trading, hesitation by policy-makers to open-up markets perpetuated market segregation and costly silos. In the US, on the other hand, a single CSD, the Depository Trust and Clearing Corporation (DTCC), operates as the back office for the entire securities market.

Turning to capital market products, a complex picture emerges once again. For investment fund markets,

Europeans also pay for the cost of fragmentation, with an average small size per fund, and thus higher costs and lower returns. Europe has a multitude of funds, spread over bonds, equity, money markets, mixed and specialised funds, and also spread across many different providers, which often sell only their own funds. The average European mutual fund is valued at €222 million, which is one-seventh the size of a typical US fund which has on average €1.6 billion in assets (see ECMI Statistical Package, 2014). Consequently, the total expense ratio, or the costs for managing the funds is about 50% higher in Europe than in the US with 1.5% as compared to 1% (see EFAMA, 2011 and ICI, 2013). This also prevents European funds from investing more in large long-term projects, which require size to diversify. The recent agreement on ELTIF (European Long-Term Investment Funds) will not change this picture, on the contrary, it will maintain fragmentation in Europe's fund markets on the basis of the type of assets.

Figure 3. Total number and average size of mutual funds in the EU and the US (Q3, 2014)*



*Funds of funds are not included, except for FR, DE, IT, LU.

Source: EFAMA, International Statistical Release (2015).

A different picture emerges for pension funds, however. Over the last decade (December 2001-June 2011), the performance of pension funds in the US and UK was negative, amongst others as a result of high management fees (OECD, 2012). According to the OECD, countries with large numbers of small funds tend to have higher operating costs on average than countries with a small number of relatively large funds, such as the Netherlands or Denmark. Annual management fees, applied yearly to the value of accumulated assets, were near 0.13% in the Netherlands on average while they exceed 0.70% in the United Kingdom. Differences in costs can over time lead to substantial differences in benefits, above all for long-term investments (De Manuel & Lannoo, 2013, p. 69, pp. 82-84).

Both fund examples show that fragmentation has a cost, but it is a form of fragmentation that cannot be easily overcome. In both cases, national idiosyncrasies matter: for investment funds, it is the savings habits of households; for pension funds, it is the national organisation of the pension funds industry. The status quo is only second best, as the picture sketched above undermines the trust of households to invest in the markets, and long term.

4. What should the EU do?

Given the complexity of these challenges, a Capital Markets Union programme will be very difficult to delineate. Much depends on the level of ambition and the objectives pursued. The first priority should be to complete the single market to achieve more depth, breadth and scale. Considering that many measures

were adopted during the financial crisis that create the regulatory framework for the different actors in capital markets, enforcement is the key task. And that's where the analogy with Banking Union arises. New initiatives, or filling gaps in the regulatory framework, could be a second priority, but this will depend upon the objective: Are new regulatory initiatives required to overcome market fragmentation? Or should the focus mainly be to broaden funding sources and facilitate capital market financing to ease access to finance for SMEs?

Following the G-20 agenda, the financial crisis led to a raft of new measures that will also complete the regulatory framework for the different players in capital markets, as laid out in Table 1. New rules have been adopted covering rating agents, infrastructure and funds, and amendments have been made to the core MiFID provisions covering price transparency, intermediaries, data providers, but most of these measures are still in the course of implementation, and it is too early to examine effects. The most important issue at this stage is enforcement, which has been strengthened by the creation of ESMA in 2010, and its enhanced powers under additional regulatory measures. But can ESMA cope, and does the structure for cooperation work? This is where the Review of the European Supervisory Authorities (ESAs) comes in.

Enhance ESMA or conduct supervision in the EU

Unlike the EBA (European Banking Authority), which has together with Banking Union become a standard setter, the European Securities and Markets Authority (ESMA) will continue to combine regulatory and supervisory tasks and no drastic change can be expected in the near future in its role. The main problem is that following the centralisation of prudential supervision of banks in the SSM, the functional separation of the ESAs in banking, insurance and securities markets supervisors may prevent closer and more efficient cooperation among conduct supervisors at EU level on capital markets issues. The structure at member-state level is even more complex, with a diversity in the financial supervisory models, and sometimes different authorities in charge, also as regards capital markets. Furthermore, ESAs are overwhelmed by regulatory tasks, with the Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS), which often prevent them from pursuing their supervisory tasks, with the limited budget under which they function. For example, the powers that ESAs wield regarding financial products and consumer/investor protection have not been used (Article 9 ESAs Regulation).

What could be done?

- The ESAs are structured too much as coordinating authorities, or executive agencies of the European Commission, without being given sufficient clout over the member states. This is already clear from the governance structure, whereby the chair and managing director have no vote on the board of supervisors. This should be changed.
- As the regulatory tasks will hopefully soon be diminishing, the ESAs should launch some high-profile, coordinated cross-border actions on financial products or practices. However, initiatives such as the law suit brought by the UK against the powers of ESMA in the Short-Selling Directive, which the UK lost, are entirely counterproductive. But it indicates the unwillingness of member states to see more power transferred to the centre, and thus more Union in this domain.
- On the supervisory level, ESMA should have the supervisory tasks that it deserves. Allocating supervisory tasks in a haphazard way makes no sense. So far, ESMA is the unique authority supervising Credit Rating Agencies and Trade Repositories, but not granting this role in the context of the draft benchmark Regulation makes no sense, as many critical benchmarks are European or global by nature. The same could be said for the data monitors under MiFID II.
- The ESAs' data collection capacity should be enhanced, and member state authorities should cooperate more. The experiences with and the outcome of the EBAs' first and second stress tests are still fresh. Also the other two ESAs experienced data collection problems, and earlier initiatives had to be discontinued because of limited means.

In the ongoing ESA Review, the European Commission unfortunately did not address these matters, although they were discussed by the European Parliament in its report on the subject. In essence, the Commission report on the ESAs chose to avoid the debate on sensitive issues, whereas the EP called for a full review of applicable regulations, covering the governance and the role of the chair, the powers exercised and the rule-making by the ESAs and the European Commission, inter alia.

Does this mean that the EU needs an SEC if it puts a Capital Markets Union in place? Most likely not, if action is taken to adjust the mandates and functioning of the ESAs, and ESMA in particular, in response to market needs and policy developments. The incapacity to address these matters at the level of the ESAs also means that more and more tasks will be taken over by the larger and more efficient ECB in the longer run.

The ECB has become the supervisor for the 120 largest banks in the Eurozone and it will become the ultimate securities settlement entity under Target 2 Securities from 2016 for the large majority of the EU countries. Also outside the eurozone, it is already increasingly collecting statistics on a growing number of matters, covering securities markets and funds, but mostly limited to the euro area, and is launching unconventional monetary policy actions with a direct impact on capital markets.

Revisit the ecosystem of capital markets

Since Europe remains highly fragmented, with many financial centres, big and small, structures need to be adapted to this diversity. Capital markets require local knowledge, both for the financing needs of sovereign states and even more so for local enterprises. Exchanges have continued to operate in most member states, and act as a local market to respond to funding needs, but many smaller market intermediaries and brokers have disappeared or been absorbed by larger banks. Several larger banks, on the other hand, have reduced their capital market activities, or may have to spin these off as a result of national or European legislation. Hence 'market-making' is threatened on the supply side on both ends, which exacerbates the problem for smaller enterprises.

Now that most new rules are in place, an assessment should be undertaken of how different markets have been impacted. A common complaint is that many firms have become "too small to comply". The rulemaking at levels 1 and 2 has become so pervasive, and the litigation cases so costly, that markets have been gripped by a compliance fear. The single rulebook led to a race to the top in financial market regulation, and concepts such as proportionality and adequacy of the new rules have moved to a second tier. It is time to make a critical evaluation of the new regulatory framework and its impact on capital markets in particular – in short an EU Regulatory Fitness and Performance (Refit) programme for the financial sector.

Prioritise well-targeted product standardisation and harmonisation efforts

The aim should be to overcome fragmentation by EU-wide acceptable investment products. High-quality standardised ABS, ABCPs, or SME loan pools should stimulate market integration, although the memory of low quality and opaqueness of such instruments is still fresh. An EU-wide long-term retail investment product could thus be more successful.

As indicated earlier, today's EU investment fund market is highly fragmented, and could be considered as one of the main factors behind the diversity in EU capital markets development. A portable **EU-wide**

retail investment product could make an important contribution to market integration, and move savings into the economy.² In a context of bank deleveraging and de-risking, forms of dis-intermediated finance are crucial. Europe today's lacks EU-wide, well diversified and stable investment products. While these exist at national level, through life insurance or pension fund products, they are unavailable at EU level. UCITS, the EU investment fund product, is not necessarily the hallmark for a well-diversified investment product, and attempts to create an EU-wide pension product have failed so far because of the link with social and tax policy.

Re-developing **securitisation** in the EU, as a way to package small or illiquid financial instruments into larger more tradable products could be a useful way to open-up financial markets. The total volume of outstanding securitisation products in the EU today is about 1/6 that of the US (AFME, 2014). With a tight regulatory framework for rating agents and a new set of capital rules for banks for securitised products, some progress has been made, but the diversity in the underlying company and insolvency law frameworks will continue to be a barrier that will require more time to overcome.

Further harmonisation of **accounting standards** should figure high on the agenda. Today, IFRS (international financial reporting standards) only apply to listed corporations at a consolidated level. The large majority of enterprises in the EU report in local GAAP (generally accepted accounting principles), which is a big impediment for investors as well as for firms to go to the markets. Company financial data are not comparable from a European perspective, and parallel reporting under different standards is burdensome. It is confusing for investors, and could thus damage a company's market reputation. In addition, there is no EU-wide repository for company financial information, but rather a multiple set of repositories, each following different data feed formats and structures. Attempts to create a European EDGAR (Electronic Data Gathering, Analysis and Retrieval), the SEC's company financial information repository, were undertaken by CESR (Committee of European Securities Regulators), the predecessor of ESMA, but were discontinued for cost reasons. The new obligations for data providers under MiFID II will not fill this gap, as those concern market (price) information, or reporting of material information.

The EU has already announced some initiatives in the context of the **Juncker investment plan**, of which €5 billion should support risk finance for SMEs (or €75 billion with the multiplier). These include the

² As proposed by the CEPS/ECMI Task Force Report, *Saving for Retirement and Investing for Growth* (De Manuel & Lannoo, 2013).

standardisation of credit information for SMEs, amendments to the Prospectus Directive and a private placement regime. Industry organisations are currently finalising a standardisation proposal for private placements, probably the easiest form of market financing for SMEs, to allow for mutual recognition in the EU.

Facilitate more market-based finance

More market-based finance is a key objective from a European perspective, but what can more Union do to change the funding channels? The debt/equity ratio differs widely throughout the EU, as it is influenced by a raft of factors, also the degree to which it is effectively market-based. Equity is related to corporate control, an area where sensitivities are entirely different in Europe than in the US. And within Europe, many different approaches exist on the control rights of equity. Debt finance on the other hand is favoured by tax legislation, where again changes or more harmonisation will be extremely difficult to pursue, even if the case for a more tax-neutral system is obvious.

As indicated before, much work has been done to harmonise the framework for market-based finance in the EU. Back in the early 1990s, Europe, with some exceptions, hardly had a capital market, and the development that has taken place in the meantime has benefitted from the emergence of a more harmonised regulatory framework, certainly for large corporations. The adaptations to the Prospectus Directive and the Transparency Directive, both adopted in 2004, eased capital raising and harmonised information requirements, but were mostly adapted for large corporations. MiFID I created the Multilateral Trading Facilities (MTF) as a second-tier organised market, which exchanges have used for their alternative small-cap markets. The MiFID II (Art. 35) aims for a further harmonisation of SME growth markets, but it remains to be seen how effective this will be.

Notwithstanding these rules, SMEs will remain discouraged from raising capital or debt directly as a result of the high cost, numerous obligations and the related fear of litigation. The only market in the EU that managed to develop a well-functioning equity market for SMEs is the London Stock Exchange with the AIM market, with more than 1,000 listings, the large majority of which are British, and a total market capitalisation of €95 billion (January 2015). The alternative segments in the other countries are much less developed, even more for debt finance.

Different public initiatives have been undertaken to facilitate access to equity finance for SMEs. At the

member-state level, this was mostly through seed finance or venture capital, but it is much less developed than debt finance, and the resources committed are very limited. At EU level, the Juncker investment plan has set aside €5 billion for SME financing, but this is only a fraction of what was committed in the five largest EU countries under national programmes (see Infelise, 2014, p. 31).

Conclusion

Tackling the lack of integration between member states should be the key aim for more Union in Europe's capital markets, but this leads to different policy conclusions depending on the perspective. The European Commission, and the EU as a whole, will thus have a hard time agreeing on priorities.

From a regulatory perspective, it means primarily implementation and enforcement of the new pieces of legislation and the amendments that were agreed during the crisis. Many of these have completed the regulatory framework necessary for a capital market to work efficiently. Secondly, it means some targeted initiatives, including the pooling of household savings in sizeable EU-wide investment funds, further harmonisation of accounting standards and related repositories for financial information, and possibly securitisation.

From a supervisory perspective, Union means better and more coordination of oversight and more specific centralised forms of supervision, where needed and justified. The inability to move forward in these areas will damage the reputation of the EU's capital market as a whole. However, the European Commission, and even more so the member states, seem not to be willing to allow for better coordination and to give more supervisory tasks to the European Supervisory Authorities, and even less to provide the budget to do this. This lack of resolve will simply mean that the ECB will gradually take over more powers in this domain, which will certainly not be optimal from a single market or financial supervisory perspective. Ideally, the EU should gradually move to a twin-peaks model of supervision, where conduct of business supervision, following the centralisation of prudential supervision for the eurozone, becomes more coordinated at EU level. This would require closer cooperation and work-sharing amongst the ESAs, especially given that their budgets are limited.

From a market perspective, Union requires a more European perspective on the part of operators and investors than has emerged from the home bias that has prevailed so far, and that has been strengthened as a result of the sovereign crisis.

References

- AFME (Association for Financial Markets in Europe) (2014), "AFME Securitisation Data Report", Third Quarter 2014, 19 December (www.sifma.org/research/item.aspx?id=8589952453),
- Akerlof, G. (1970), "The Market for 'Lemons': Quality, Uncertainty and the Market Mechanism", *Quarterly Journal of Economics*, Vol. 90, p. 629.
- Black, B. (2000), "The Core Institutions that Support Strong Securities Markets", Working Paper No. 200, Stanford Law School John M. Olin Program in Law and Economics, Stanford University, Stanford, CA.
- De Manuel, M. and K. Lannoo (2013), *Saving for retirement and investing for growth*, CEPS Task Force Report, CEPS, Brussels, September.
- Demarigny, F. and C. Clerc (2010), "Transparency Directive Assessment Report", Mazars.
- ECB (2014), "Financial Market Integration Report", presented at Joint ECB-EC Conference on Financial Integration, Frankfurt, 28 April (www.ecb.europa.eu/events/conferences/shared/pdf/finintrep_pres.pdf?fc499fd5f7b9672e75e92b80240d915d).
- ECMI (2014), Statistical Package (www.ceps.eu/book/2014-ecmi-statistical-package).
- EFAMA (2011), "Fund Fees in Europe" (www.efama.org/Publications/Statistics/Other%20Reports/EFAMA_Fund%20Fees%20in%20Europe%202011.pdf).
- European Commission (2014a), Report from the Commission to the European Parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS), Brussels, August.
- European Commission (2014b), "An Investment Plan for Europe", Brussels, November.
- European Parliament (2014), Report with recommendations to the Commission on the European System of Financial Supervision (ESFS) Review, Brussels, February.
- Gros, D. and K. Lannoo (1998), *Capital Markets and EMU*, CEPS Working Party Report, Chairman Dr Tommaso Padoa-Schioppa, CEPS, Brussels, June.
- Infelisi, F. (2014), "Supporting access to finance by SMEs", CEPS Policy Brief, CEPS, Brussels, April.
- Investment Company Institute (ICI) (2013), "Average Expense Ratios Paid by Mutual Fund Investors Continued to Decline in 2012", Washington, D.C. (www.ici.org/pressroom/news/13_news_trends_expenses).
- Lannoo, K. and A. Khachaturyan (2003), *Disclosure regulation in the EU: The emerging framework*, CEPS Working Party Report, CEPS, Brussels, October.
- Lannoo, K. (1999), "Does Europe need an SEC?", Occasional Paper No. 1, European Capital Markets Institute, Brussels, November.
- OECD (2012), *OECD Pensions Outlook 2012*, Paris.
- Romano, R. (2001), "The Need for Competition in International Securities Regulation", Yale Law School Working Paper, Yale University, New Haven, CT.
- Valiante, D. and K. Lannoo (2011), *MiFID 2.0.: Casting New Light on Europe's Capital Market*, CEPS Task Force Report, CEPS Brussels, February.