Part I General Aspects, 1 Capital Markets Union after Brexit

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(p. 3) 1 Capital Markets Union after Brexit

I. Introduction

1.01 The European Commission wishes to create fully integrated European capital markets. The Commission's Capital Markets Union (CMU) Action Plan is intended to make it easier for providers and receivers of funds to come into contact with one another within Europe, especially across borders. This is regardless of whether it is arranged through the intermediary of a bank, through the capital markets, or through alternative channels such as crowdfunding. In addition, more non-bank funding will help to lessen dependence on the traditional banking industry and enhance the ability to cope with economic shocks.

1.02 But will the CMU Action Plan be sufficient to achieve a truly integrated European capital market? And is the CMU Action Plan still realistic if London, Europe's financial heart, no longer participates as a result of Brexit? Moreover, what impact will the Trump administration and the victory of Emmanuel Macron have on the CMU project? These are questions which cannot be answered with any certainty at present.

1.03 Whether the recent political developments will pose an existential threat to the EU or will instead spark a new wave of European integration and reform within the EU27 remains to be seen. In the meantime, the Commission's stance is clear. It sees no reason for taking its foot off the accelerator in introducing the CMU. Indeed, it believes that the CMU measures must be accelerated.[1]

1.04 In this book, various aspects of the CMU will be analysed and discussed from a legal and/or economic perspective. The book chapters are grouped in a thematic way, covering the following areas: (i) general aspects, (ii) Brexit, (iii) financing innovation, (iv) raising capital on the capital markets, (v) fostering retail and institutional investment, (vi) leveraging banking capacity to support the wider economy, and (vii) facilitating cross-border investing.

(p. 4) **1.05** In this chapter we will briefly outline some general aspects of CMU that are not explicitly covered by the other chapters in this book: (1) the CMU objectives, (2) the EBU–CMU relationship, (3) regulatory burden, and (4) Better Regulation and the Call for Evidence.

II. CMU Objectives

1.06 The Commission formulated the CMU's overarching objective as follows:

> [CMU] seeks to better connect savings to investment and to strengthen the European financial system by enhancing private risk-sharing, providing alternative sources of financing and increasing options for retail and institutional investors. Removing obstacles to the free flow of capital across borders will strengthen Economic and Monetary Union by supporting economic convergence and helping to cushion economic shocks in the euro area and beyond, making the European economy more resilient. This is even more important in the current economic environment.[2]

1.07 This overarching objective is then broken down by the Commission into six more specific objectives:

(i) creating a single capital market by eliminating barriers between Member States to cross-border investment;

(ii) improving access to funding for all businesses in Europe;

(iii) diversifying sources of funding and reducing costs of accessing capital;

(iv) maximizing the benefits of capital markets so that they can stimulate economic growth and employment;

(v) improving funding options for SMEs;

(vi) helping the EU to attract investment from international investors and become more globally competitive. [3]

III. EBU–CMU Relationship

1.08 Another European project—the European Banking Union (EBU)—was clearly born under a more favourable constellation. Although the EBU is not yet complete, managing to establish a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM) within the eurozone in such a short space of time is a tremendous achievement. The SSM has been operational since November 2014 and provides for the European Central Bank (ECB) in Frankfurt to carry out prudential supervision directly over the main banks within the eurozone. Moreover, since January 2016 the Single Resolution Board (SRB) in Brussels has been in charge of the orderly resolution of failing banks in the eurozone.[4]

1.09 How do these two European mega projects relate to one another? And, above all, what are the differences? First, the CMU focuses not on the financial services industry but on the European economy as a whole. Second, financial stability is not the primary driver (unlike (p. 5) in the case of the EBU), but is simply a precondition for the development of the CMU. Third, institutional issues do not form the essence of the CMU, although institutional reforms may be necessary in order to achieve its objectives.[5] Fourth, the geographical scope of the CMU is not confined to the eurozone but extends to the EU as a whole. Although Brexit means that the difference will be smaller, it will still exist. Fifth, the CMU is not triggered by crisis management challenges, but is part of a broader long-term agenda for structural change in Europe. This was markedly different in the case of the EBU. The main motive for establishing the EBU was the eurozone crisis. But sixth, the banks play an essential role in the capital markets, even in systems such as the US where the capital markets are more highly developed. The correct initiatives for banks and capital markets can in this way be mutually reinforcing.[6]

IV. Regulatory Burden

1.10 But what are the ‘correct initiatives’? In short, how does the Commission envisage achieving the CMU? The CMU cannot in any event be achieved by a single measure. Examination of the CMU Action Plan quickly reveals that the Commission believes the solution lies mainly in adjusting the legislation.

1.11 To start with, properly regulating the financial services industry is no easy matter. Regulation should be neither unduly strict nor unduly lenient. Nor should it be unduly vague (since this is at the expense of legal certainty) or excessively detailed (since this is at the expense of flexibility).

1.12 Nonetheless, the regulatory (compliance) burden is starting to become a problem for the financial services industry. In response to the financial crisis, the Commission quickly erected a complex regulatory structure comprising as many as forty new directives and regulations. And this structure is not yet complete. A notorious example is the Capital Requirements Regulation (CRR), which takes up no fewer than 337 closely printed pages.[7] And this is just one regulation. Moreover, the rules sometimes contain mutually contradictory or overlapping provisions or even gaps. The complex interaction of all these new rules can also have undesirable economic consequences.

1.13 And, for the people who have to cope with this flood of legislation, are the rules still readily identifiable and comprehensible? This applies not only to staff of the financial services industry itself but also to the financial supervisors who have to monitor compliance with the rules. Hardly surprisingly, therefore, that the supervisory authorities have seen a huge increase in their staff complement in recent years and hence also in the costs of supervision.

(p. 6) V. Better Regulation and Call for Evidence

1.14 Fortunately, the Commission has recently become more aware of the problem of the regulatory burden. This is apparent from the Better Regulation Programme, which aims to cut down on the number of new rules and evaluate existing rules more critically.[8] In April 2016, the Commission concluded an Interinstitutional Agreement on Better Law-Making[9] with the Council and the European Parliament:

> The Commission sees this agreement as a joint commitment to focus on the big and urgent things, whilst striving for simple, evidence-based, predictable and proportionate laws which deliver maximum benefits for citizens and businesses.[10]

1.15 It is also to be welcomed that the Commission, in its call for evidence in the context of the CMU, asked the market what rules are inconsistent and give rise to undesirable economic consequences.[11]

1.16 The call has elicited no fewer than 288 responses.[12] These are mainly from the financial services industry, but other bodies such as consumer organizations and think tanks have also responded. On 16 July 2016 the Commission published a summary of the responses, followed on 23 November 2016 by an overview of policy actions, in part already undertaken by the Commission.[13]

1.17 Out of the feedback received, one of the key points of criticism is that strict regulation is limiting the quantity of bank financing available in the economy. But other responses emphasize that the higher capital requirements (CRD IV and CRR[14]) are actually having a positive impact on investor confidence and will in due course benefit the economy. According to these respondents, the volume of lending has declined because demand for loans has fallen.[15] The Commission concludes that the strict capital requirements are necessary to ensure financial stability, but that the requirements can be relaxed in some areas.

(p. 7) **1.18** These changes have been taken into account in the current review of the European banking rules. The Commission published the CCR2 package and its response to the call on 23 November 2016.[16]

1.19 Another key point of criticism is that the legislation is not always proportionate, for example for small banks.[17] Here too, the respondents' concerns have struck a chord with the Commission. For example, the CRR2 package mentioned above also provides for a less onerous disclosure regime and simpler remuneration rules for small, non-complex banks.[18]

1.20 There are also complaints about excessive compliance costs, especially for smaller institutions. These costs are due to the complexity and sheer number of rules and duplication of reporting requirements in various regulatory schemes. In addition, the quantity of information requested is not always proportionate to the targeted risk.[19] The Commission is also sympathetic to this oft-heard complaint. For example, the CCR2 package provides for a reduction of the reporting frequency for small, non-complex banks. In addition, the Commission has announced a more comprehensive study of reporting obligations in the financial services industry.[20]

1.21 But are the measures that have been announced sufficient? The Commission faces a difficult task. Determining the correct level of regulation for the financial services industry has always been hard. And the degree of complexity has now been increased by Brexit and the advent of Trump.

VI. Final Remarks

1.22 On the whole, it is clear from this volume's chapters that there is no lack of well-intentioned initiatives. But is the CMU Action Plan sufficient to achieve an integrated European capital market? Numerous other measures are in any event conceivable.[21] And is the CMU Action Plan still realistic if London—Europe's financial heart—no longer takes part? And how will the Trump administration affect the CMU project? These are questions which cannot be answered with any certainty at present. The future is a black box. This has naturally always been the case, but Brexit and Trump are now forcing us to face facts. We are on the threshold of a period of great uncertainty.

(p. 8) **1.23** The EU is facing some major tests, also in relation to the CMU. The time has come for a radical modernization of the EU, including the governance of the European institutions and the European supervisory authorities such as ESMA. This will require the European leaders to work together effectively. The election of the pro-European Emmanuel Macron as the new President of France may give us some hope in this respect.

Footnotes:

1 See European Commission, 'Capital Markets Union—Accelerating Reform' COM (2016) 601 final (14 September 2016). See also European Commission, 'Commission Work Programme 2017—Delivering a Europe that Protects, Empowers and Defends' COM (2016) 710 final (25 October 2016) 9; See European Commission, 'Mid-Term Review of the Capital Markets Union Action Plan' COM (2017) 292 final (8 June 2017).

2 See COM (2016) 601 final (n 1) 2.

3 See European Commission, 'Action Plan on Building a Capital Markets Union' COM (2015) 468 final (30 September 2015).

4 See eg Danny Busch and Guido Ferrarini (eds), *European Banking Union* (OUP 2015).

5 See Danny Busch, 'A Stronger Role for the European Supervisory Authorities in the EU27', ch 3 in this volume; Emilios Avgouleas and Guido Ferrarini, 'The Future of ESMA and a Single Listing Authority and Securities Regulator for the CMU: Costs, Benefits, and Legal Impediments', ch 4 in this volume.

6 See Nicolas Véron and Guntram Wolff, 'Capital Markets Union: A Vision for the Long Term' (2016) 2 Journal of Financial Regulation 130, 132.

[7] Regulation (EU) 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L176 (27 June 2013) 1–337.

[8] As regards Better Regulation, see eg European Commission, 'Better Regulation: Delivering Better Results for a Stronger Union' COM (2016) 615 final (14 September 2016).

[9] 'Interinstitutional Agreement of 13 April 2016 on Better Law-Making' [2016] OJ L123/1.

[10] See COM (2016) 710 final (n 1) 16.

[11] European Commission, 'Call for Evidence—EU Regulatory Framework for Financial Services <http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-document_en.pdf> accessed 1 August 2017.

[12] The responses can be downloaded at <https://ec.europa.eu/eusurvey/publication/financial-regulatory-framework-review-2015?language=en> accessed 1 August 2017.

[13] European Commission, 'Summary of the Contributions to the "Call for Evidence"' < http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/summary-of-responses_en.pdf> accessed 1 August 2017; European Commission, 'Call for Evidence—EU regulatory framework for financial services' COM (2016) 855 final (23 November 2016); European Commission, 'Commission Staff Working Document on the Call for Evidence' SWD (2016) 359 final (23 November 2016).

[14] The full title of CRD IV (Capital Requirements Directive IV) is as follows: Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, [2013] OJ L176 (27 June 2013) 338–436. As regards the CRR (Capital Requirements Regulation), see n 7 above.

[15] See European Commission, 'Summary of Contributions' (n 13) 8–9.

[16] See COM(2016) 855 final (n 13) 4–7 (many more policy actions are listed here). The CCR2 package refers to the combination of risk reduction measures in the following proposals: Proposal for a Regulation of the European Parliament and the Council amending Regulation (EU) No 575/2013 and Regulation (EU) No 648/2012 COM (2016) 850 final (23 November 2016); Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU COM (2016) 854 final (23 November 2016); Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU COM (2016) 853 final (23 November 2016); Proposal for a Regulation of the European Parliament and the Council amending Regulation (EU) No 806/2014, COM (2016) 851 final (23 November 2016).

[17] See European Commission, 'Summary of Contributions' (n 13) 12–13.

[18] COM (2016) 855 (n 13) 7–9.

[19] See European Commission, 'Summary of Contributions' (n 13) 13–6.

[20] See European Commission, Call for Evidence—EU regulatory framework for financial services (available at <http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-document_en.pdf> accessed 1 August 2017) 9–11.

[21] See several chapters included in this book and see eg Diego Valiante, *Europe's Untapped Capital Market—Rethinking Financial Integration after the Crisis* (CEPS Paperback, Rowman & Littlefield International 2016); Véron and Wolff (n 6).