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Capital Markets Union: Slow start towards an ambitious goal

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Auditing a fundamental freedom: The free movement of capital

- Already **from 1966**, the Commission has intended to **build a single market for capital**. It revived this idea in its **2015 Action Plan**, which laid down foundations for a well-functioning **Capital Markets Union (CMU)**.
- In March 2019, the Commission announced in its CMU progress report it delivered on its promise. To support this process and provide assurance on the status of the CMU, **we audited the effectiveness of the actions taken since 2015** and progress made towards the set objectives.
- We assessed whether the Commission:
 - helped **diversifying** the financing of companies, in particular SMEs;
 - helped the development of deeper and better integrated **local capital markets**;
 - took effective action to tackle key **cross-border barriers**; and
 - equipped the CMU with a convincing **performance framework**.



What did we find?

- The **objectives** of building an efficient single market for capital **are ambitious** but the expected rewards are worth the effort. The Commission made **first steps** towards building a well-functioning CMU, but the **results are still to come**.
- Many of the steps the Commission was able to take within its remit were **not able to act as a catalyst for change in the EU so far**. Many of the key actions can only be undertaken by Member States or with their full support. This includes key **cross-border barriers** to investment, which remain largely **unresolved** to date.
- Despite the measures implemented to **diversify funding sources** for SMEs, **no structural shift** towards more market funding can be observed so far.



Conclusion 1: Access to finance for SMEs – no structural shift so far

➤ Diversification of funding sources for SMEs:

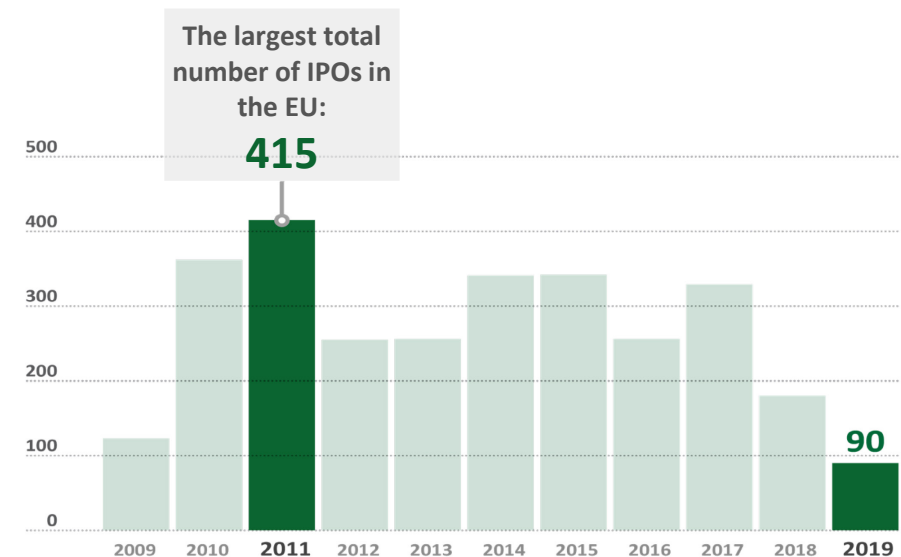
- only **partial results** in supporting **venture capital and equity financing** (EuVECA and EuSEF, pan-European fund-of-funds, best practices and reports);
- **no improved access to public markets** so far (Regulation on prospectus, SME growth markets regulation and amendments to Market Abuse Regulation).

➤ Information barriers for the financing market for SMEs still prevail.

➤ CMU actions for additional SME lending through the new **STS securitisation** label have **not yet produced tangible results**.

➤ In 2019 the new label covered almost half of the EU market share (46 % or €100 billion) but the overall securitisation market did not show signs of growth.

Total number of IPOs in the EU 2009-2019



Source: ECA based on PwC, IPO Watch Europe 2009-2019

* All conclusions as of May 2020 (end of the audit work).

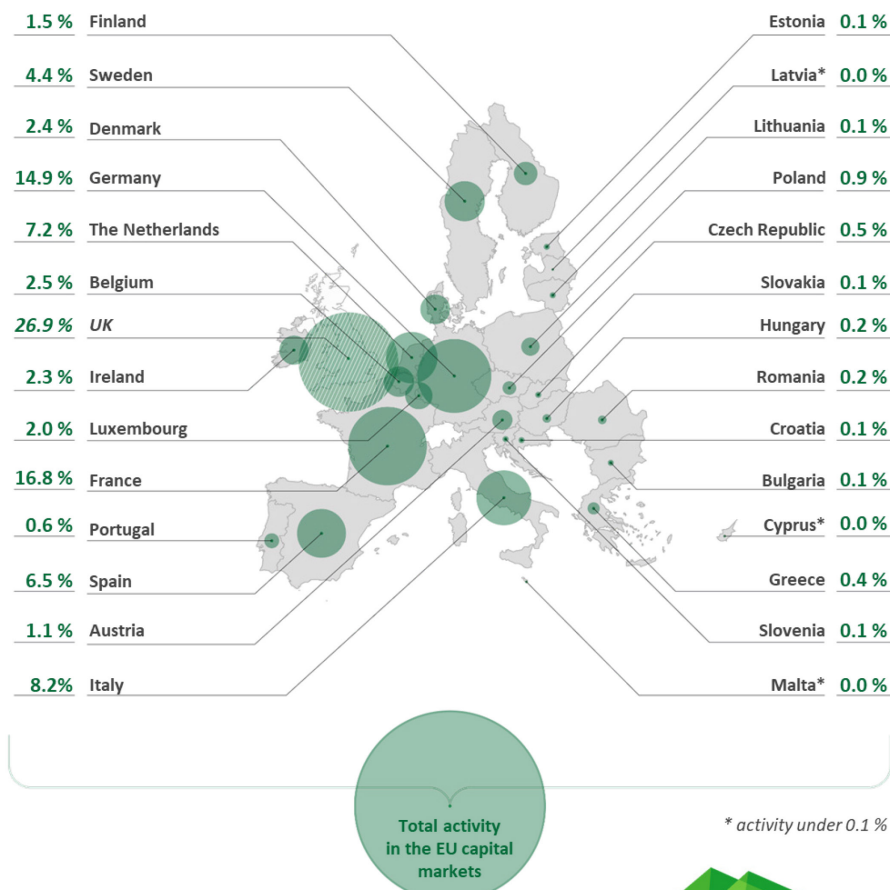


Conclusion 2: Shortcomings in the Commission's efforts to develop local capital markets

- EU capital markets remain **heterogeneous** and concentrated in Western and Northern Europe
- **Convergence** at EU level is **still low**
- Capital markets require **security for investors**, which includes:
 - understanding of the local legal framework;
 - understanding of the local (corporate) culture;
 - knowledge of local sectors and consumer trends;
 - trust in adequate (national) supervision of accounting, audit and capital markets.

This is a **particular challenge for smaller, less developed capital markets!**

Size of capital markets by country measured by the average share of total activity across 23 different sectors in the three years to 2019 (average), in %



Source: ECA based on New Financial data, September 2020



Conclusion 2: Shortcomings in the Commission's efforts to develop local capital markets

- **No comprehensive strategy to develop local capital markets**, as the Commission's March 2019 report did not include a long-term perspective for all capital market segments and concrete actions to be taken.
- **European Semester is not used to its full potential** to foster relevant reforms as:
 - no Country Specific Recommendations relevant to the CMU objectives were **issued to five Member States** with less developed capital markets and no recommendation was aiming at promoting **cross-border integration of local capital markets**; and
 - the **implementation of recommendations** was **partial** at the end of 2019.
- **The demand-driven approach of the Commission's technical assistance was not conducive** to providing support to the Member States in need. In particular:
 - there was **significant divergence among Member States**. Six Member States with less developed capital markets had implemented zero or only one CMU-relevant project.
 - **most of the sampled projects** were **still under implementation** at the end of the audit. So far, results have been mixed.



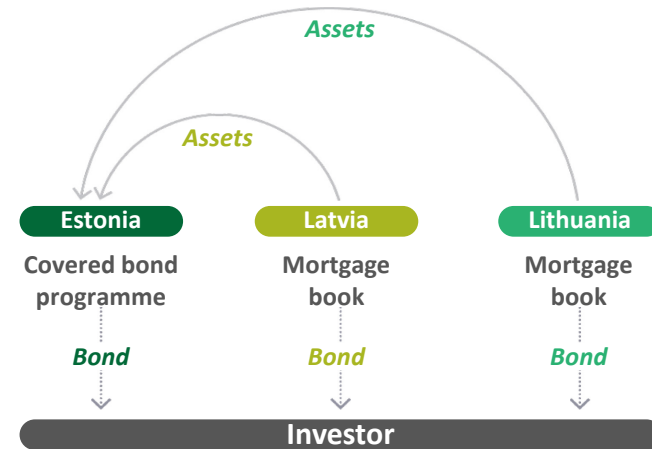
Deep-dive: Multi-country projects are still the exception

Covered bonds – legal and regulatory reforms in the Baltic countries

The Commission, together with the European Bank for Reconstruction and Development, is supporting the Baltic States with the introduction of a **pan-Baltic covered bond framework**, contributing towards:

- well-functioning and larger capital markets in the region;
- opening up long-term funding options for banks; and
- increasing the level of lending to economies.

However, **multi-country projects are still the exception** (only 2 such projects).



Taking assets from all three countries:

An i.e. Estonia-based bank uses the Estonian covered bond law.

The Estonian covered law allows Latvian and Lithuanian assets to be used.

Latvian and Lithuanian laws facilitate the transfer of assets to Estonia.

Source: ECA based on EBRD.



Conclusion 3: CMU actions alone could not lead to break-through in removing cross-border barriers

Financial Literacy



- The Joint Commission – Member States Expert Group recommended in 2018 that **Member States measure financial literacy rates and implement financial education programmes** in line with OECD principles.
- At the time of our audit, **the Commission had not yet stated if and how it would support Member States** in their efforts.

Insolvency Law



- The **Commission's actions** have the potential to clarify ownership rights and facilitate restructuring of struggling businesses.
- They **are unlikely to lead to a substantial convergence of insolvency proceedings.**
- A comparative study and survey findings suggest there are **targeted areas** for further approximation of national laws or harmonisation at EU level.

Withholding Tax



- Commission issued a non-binding **Code of Conduct on withholding tax.**
- **More binding approximation of national practices requires unanimity in the Council** and a special legislative procedure.
- Commission announced further actions in Tax Action Plan 2020.



Deep-dive: Financial literacy

- Work done by the Commission, the European Central Bank and the OECD - all conclude that **financial literacy in the EU is heterogeneous**;
- A key issue is the **lack of financial literacy in many SMEs**, especially in Central and Eastern Member States causing **preference for bank financing** rather than talking to equity and venture capital providers;
- A number of **structures and platforms are available at EU-level** to provide retail investors and SMEs with financial advice. Some of these are at least partly funded through the EU budget and are intended inter alia to ease access to finance for SMEs, such as the **Enterprise Europe Network, the European Investment Advisory Hub**, etc.;
- The Commission has not yet stated if and how it will support Member States in their efforts to foster financial literacy. The Commission should therefor assess how it can **better foster financial literacy of consumers, investors and SMEs across Europe**.





Conclusion 4: Design and monitoring to be improved

Design

- No explicit **prioritisation** from the start of the CMU project.
- **CMU objectives** were in many cases **vague**.
- The Commission's communication raised **high expectations** beyond what was achievable, this also due to the nature of many measures.
- At the time of the audit, only 5 out of 13 legislative measures were (partially or fully) applicable.

Monitoring

- The Commission focused on progress with legislative measures.
- **No regular and consistent monitoring** of progress on main CMU objectives.
- The Commission has taken steps to develop a dashboard of Key Performance Indicators.
- Dashboard to be rooted evidence-based intervention logic.

Data

- **Data needed** for monitoring often not available in sufficient quality and detail.
- **Assembling the data** from external sources costly and time-consuming and quality uncertain.
- The Commission has started to include **data clauses in legislation**.
- Additional reporting burdens on industry must be carefully justified.



Our recommendations

The Commission should:

1

propose **well-targeted actions to further facilitate SME access to capital markets** by reducing information asymmetry between market participants and increasing the **attractiveness of equity financing**;

2

foster **deeper and better integrated local capital markets** by developing a comprehensive strategy addressing the needs of local capital markets and enhancing the technical support provided;

3

address key cross-border barriers to investment such as different elements of national insolvency proceedings, withholding tax issues and a lack of financial education, in particular, assess how it can better **promote financial literacy**, including **among SMEs**, and **support Member States'** efforts in this area; and

4

define specific objectives, prioritise critical measures and **monitor progress of implementation of the CMU** based on selected suitable indicators.



ECA's on-going work on financial and economic governance

The [new ECA Strategy](#) and the [AWP 2021+](#) have been published in Q1.

To be published in 2021:

- Performance audit on **sustainable finance** (September)
- Performance audit on **post-programme surveillance** (September)

To be published in 2022:

- Performance audit on the **single market for investment funds**
- Performance audit on **EU banking supervision**
- Performance audit on **national recovery and resilience plans**



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