

Capital Markets Union: Ten Years Later



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Abstract

The European Union's project of capital markets union (CMU) has disappointed in its first decade. The best way to revitalise it is to focus on supervisory integration through in-depth reform and further empowerment of the European Securities and Markets Authority. If, conversely, more integrated supervision cannot be achieved, then it may be time to discard the CMU slogan altogether.

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LIST OF ABBREVIATIONS

AMLA	Anti-Money Laundering Authority
CESR	Committee of European Securities Regulators
CMU	Capital Markets Union
DG FISMA	Directorate-General for Financial Stability, Financial Services and Capital Markets Union
EBA	European Banking Authority
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ELTIF	European Long-Term Investment Fund
EMIR	European Market Infrastructure Regulation
ESA	European Supervisory Authority
ESAP	European Single Access Point
ESMA	European Securities and Markets Authority
FESCO	Forum of European Securities Commissions
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
SRB	Single Resolution Board

EXECUTIVE SUMMARY

The European Union project of a capital markets union (CMU) was born in July 2014 from a combination of diverse factors, most prominently the realization that the EU financial system was excessively bank-based and the desire for a positive vision to tilt the balance of a forthcoming referendum on EU membership in the United Kingdom. The economic case for CMU combines considerations of financial stability (primarily in the euro area), of economic efficiency for the financing of innovation and investments, and of fairness in terms of equal access to capital across the Union. On that basis, the CMU project has received broad rhetorical support across the EU.

That apparent support, however, has failed to materialize into transformational EU policies and structural change in the EU financial system. The failure is primarily due to the inertia inherent in overcoming nationalistic defensiveness and incumbent special interests in the public and private sector. It also mirrors excessive initial optimism about moving the needle in several policy areas that are not primarily driven by financial regulatory concerns, such as taxation, insolvency law, and pension finance.

Against that backdrop, a revival of the CMU vision is desirable and should be focused on reform that is achievable while being more than incremental. The best chance for that is to focus on supervisory integration. This is because a single rulebook is necessary but not sufficient to make a single market. In the heavily regulated financial sector, outcomes depend not only on the rules but on who is in charge of enforcing them: even fully harmonized rules, if implemented differently under different authorities in different member states, will not deliver European market integration. Conversely, supervisory integration would be insufficient to effect cross-border market integration, but it could play a catalytic role as the empowered EU authority would be positioned to identify the obstacles and provide consistent advocacy for their removal.

In practice, supervisory integration would entail profoundly overhauling the European Securities and Markets Authority (ESMA) and empowering it with more direct supervisory mandates. While this option has been discussed and attempted before, the current environment provides both a greater sense of urgency and more available proofs of concept in adjacent areas than in the past. Specifically, the experience of European banking supervision since 2014 grants credibility to the view that supervisory integration, if executed right, can lead to not only more uniform but also more effective supervision.

ESMA's future governance and funding could best be modelled on what has been decided for the soon-to-be-established EU Anti-Money Laundering Authority, which incorporates the lessons of several earlier experiences in EU agency design. With due delay for preparation, its scope of direct supervisory authority should be expanded to EU-systemic financial market infrastructures, the enforcement of reporting requirements for which cross-border consistency is paramount, and other wholesale market supervisory mandates.

The overhaul and empowerment of ESMA could pave the way, over a longer-term horizon, towards a "twin-peaks" supervisory architecture for the EU financial system, with the reformed ESMA in charge of EU-level conduct-of-business supervision across the financial system including the banking and insurance sectors. That design would better address concerns about the protection of investors and financial consumers, while keeping prudential authorities focused on their objectives of safety and soundness. Conversely, if the EU-wide integration of capital markets supervision, an ambitious but by no means utopian policy concept, proves unachievable, then the time may have come to stop beating the CMU drum altogether.

1. THE INCEPTION OF CAPITAL MARKETS UNION

Europe's capital markets union project has a precise birthdate. On 15 July 2014, in his maiden speech before the European Parliament, European Commission President-elect Jean-Claude Juncker mentioned the need to implement the banking union initiated two years earlier, then added (Juncker, 2014):

“Over time, I believe we should complement the new European rules for banks with a **Capital Markets Union** *[emphasis in original]*. To improve the financing of our economy, we should further develop and integrate capital markets. This would cut the cost of raising capital, notably for SMEs, and help reduce our very high dependence on bank funding. This would also increase the attractiveness of Europe as a place to invest.”

Whereas the expression does not appear to have been ever used before that speech, Juncker's policy vision was not entirely new, of course. Nearly a half-century earlier, the Segré Report, a seminal text on EU financial services policy, had been formally titled “The development of a European capital market” (European Commission, 1966).¹ In 1999, Internal Market Commissioner Mario Monti had published a “Financial Services Action Plan” that articulated an updated vision of financial sector integration by way of sectoral directives (European Commission, 1999). Two years later, the Lamfalussy Report (Lamfalussy, 2001²) led to incipient attempts at ensuring supervisory convergence with the creation of the Committee of European Securities Regulators (CESR), which however remained an essentially non-binding arrangement. In the midst of the Great Financial Crisis, the Larosière Report (Larosière, 2009³) tightened that vision by advocating a single rulebook,⁴ whose consistent implementation would be supported by three EU agencies dubbed the European supervisory authorities. These included the European Securities and Markets Authority (ESMA), which replaced CESR for capital markets and was endowed with some enforceable powers including on binding mediation.

1.1. An anti-Brexit initiative

A key albeit unstated motivation for Juncker's initiative was his desire to reduce the chances of an exit of the United Kingdom from the EU (Brexit). Since the euro area crisis had started with Greece in late 2009, a dynamic of economic and financial integration had developed in the euro area that generated a growing disconnect with the countries that were not participating in it, and primarily with the UK. In July 2011, UK Chancellor George Osborne had spoken of a “remorseless logic” that would lead the euro area towards greater fiscal union from which the UK would stay away.⁵ In mid-2012, the inception of banking union and the forceful “whatever-it-takes” pronouncement of ECB President Mario Draghi confirmed that the euro area was resolving its crisis with further institutional buildup (Véron, 2014). According to a close former aide, these developments played a key role in prompting UK Prime Minister

¹ Claudio Segré, then head of the Studies Division of the European Economic Community's Directorate-General for Economic and Financial Affairs, chaired a group of 12 experts (including Alexandre Lamfalussy, by then an executive at the private-sector Banque de Bruxelles) that delivered its report to the European Commission in November 1966.

² Alexandre Lamfalussy, former general manager of the Bank for International Settlements in Basel and founding president of the European Monetary Institute (the predecessor of the ECB), chaired the committee of 7 “wise men” that delivered its report to the ECOFIN Council in February 2001.

³ Jacques de Larosière, former managing director of the International Monetary Fund, governor of the Bank of France, and president of the European Bank for Reconstruction and Development, chaired the high-level group of 8 members that delivered its report to the European Commission in February 2009.

⁴ The expression “single rulebook” had been originally coined a few years earlier by European Central Bank Executive Board Member Tommaso Padoa-Schioppa (Padoa-Schioppa, 2004).

⁵ Chris Giles and George Parker, “[Osborne urges eurozone to ‘get a grip’](#)”, *Financial Times*, 20 July 2011.

David Cameron to publicly consider a referendum on EU membership in his Bloomberg speech of 23 January 2013 (Rogers, 2017).

Against this backdrop, Juncker's CMU vision was a way to chart an alternative path of European integration which would not only include the UK, since it would encompass the entire internal market and not just the euro area, but even place it in a central and privileged position, since London was the undisputed hub of EU capital markets. The announcement was carefully tailored to be as unobjectionable from a UK perspective as possible, at the price of avoiding any policy ideas that would be potentially controversial in London, to the point of being dismissed by some observers as "a mere marketing exercise to re-label a long-existing policy with a new name, but little new substance" (Ringe, 2015). The same intent was signalled by the appointment of a British commissioner, Jonathan Hill, to implement Juncker's agenda with a title emphasizing the new motto ("Commissioner for Financial Stability, Financial Services and Capital Markets Union"). Commissioner Hill soon confirmed his avoidance of any controversial policy options by emphasizing in his CMU rhetoric the reaping of "low-hanging fruits" as opposed to any change in supervisory architecture.⁶

The fact that Juncker's strategy failed to avert Brexit in 2016 does not imply that it was a bad political idea, of course. But it had two consequences for the CMU project. First, as mentioned above, it implied that policy ideas that would go against stated or perceived UK preferences were elided from the project early on, which among other things had precluded consideration of supervisory integration beyond what had been implemented a few years earlier with the establishment of ESMA.⁷ Second, it meant that after the UK voted to leave the EU on 23 June 2016, the CMU project was left somewhat directionless. In principle this would have provided an opportunity to redefine the endeavour and give it a more consistent focus, but in practice that opportunity was not immediately seized (Ringe, 2019).

1.2. Economic rationale(s)

In parallel with the political motivation, the CMU concept also responded to an economic agenda. As made clear by Juncker in his speech, the aim was to increase capital availability for corporate growth and to rebalance the EU financial system away from its excessive dependence on banks, which had led to procyclical credit contractions as illustrated in the previous years of crisis. This echoed a longstanding view of capital markets as "spare tires" that may keep efficiently allocating capital in the economy when the banking sector is unable to do so, as had been memorably articulated by Federal Reserve Board Chair Alan Greenspan in the aftermath of the East Asian crisis of the late 1990s (Greenspan, 1999).

The European Central Bank (ECB) was an early supporter of the CMU agenda and called for an ambitious and consistent policy approach to it, with emphasis on cross-border integration. In a speech before the European Parliament in April 2015, ECB Vice President Vitor Constâncio emphasized: "Integrated capital markets can strengthen financial stability by increasing private risk sharing, thereby facilitating the absorption of shocks throughout the EU. [...] Financial integration therefore features prominently in the Eurosystem's mission statement." Newly entrusted with its European banking supervision mandate, the ECB was engaged in a multi-year effort of bringing the euro area banking sector back to safety and

⁶ Jim Brunnsden and Alex Barker, "[Why Hill is no markets union swashbuckler](#)", *Financial Times*, 29 September 2015.

⁷ Like the two other European supervisory authorities, the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), ESMA became operational on 1 January 2011. Unlike its two sisters, it was soon endowed with direct supervisory mandates, over credit ratings agencies in 2011 and over trade repositories in 2013. The corresponding market segments are limited in scope, however, and were either unsupervised (in the case of ratings agencies) or not yet in existence (in the case of trade repositories) before they came under the direct supervision of ESMA. These ESMA mandates, therefore, did not represent any meaningful supervisory integration compared with the prior status quo. Due disclosure: the author is an independent non-executive director of DTCC Derivatives Repository Ireland, a trade repository under ESMA's direct supervision.

soundness and was therefore aligned with the Commission's aim of rebalancing the financial sector away from excessive bank dependence. In the same text, Constâncio warned about the risk of stopping halfway due to political constraints, noting pointedly that "half a capital markets union is still no capital markets union" (Constâncio, 2015).

Even so, the CMU project was affected from the start by a lack of prioritization of its aims to "further develop and integrate capital markets" as Juncker had put it in his original speech. While the two stated aims, of development and integration, are by no means fundamentally incompatible, they are also not identical. The European Commission, out of understandable concern to maximize ownership of the project in all member states, did little to dispel the inherent ambiguities. It repeatedly emphasized the value of developing national capital markets in each EU country, even though that may result in duplication and fragmentation, most obviously in the area of financial market infrastructure where the EU suffers from considerable redundancy of listing, trading, clearing, and settlement companies (Wright and Hamre, 2021).

1.3. Limited achievements

Despite a number of valuable endeavours promoted by the European Commission over the past decade, the CMU initiative has been less than a game-changer so far. A seasoned observer noted that the intense legislative effort yielded "only few tangible changes on the ground" (Demarigny, 2024; author's translation).

To be sure, it is natural that the impact of structural policy reforms such as CMU would take years to unfold. For example, the legislative acts on the European Single Access Point (ESAP), an initiative to facilitate investor access to a range of financial disclosures that has been one of the main CMU legislative pushes of the von der Leyen Commission, were published in December 2023;⁸ the ESAP platform will only become operational from 2027.⁹ Similarly, the provision of a "consolidated tape" of transactions in markets for equities, bonds and derivatives was enshrined in a 2024 revision of the Markets in Financial Instruments (MiFIR / MiFID) legislation, and the selection of consolidated tape providers to implement that vision will occur in stages in 2025 and 2026.¹⁰

Sometimes, the Commission has had to make a second attempt after an initial legislation proved to be insufficient. For example, the Commission has tried to promote a harmonized vehicle for investment into infrastructure and other illiquid assets, dubbed the European Long-Term Investment Fund (ELTIF). The first ELTIF legislation, enacted in 2015, had only disappointing impact; the Commission expects that the revision of 2023 will be more powerful.¹¹

Even so, while a number of the Commission's CMU projects, including the three mentioned above (ESAP, consolidated tape, ELTIF) and a legislative package on corporate listings,¹² are likely to prove useful, they stop well short of being transformational. In the area of capital markets, it is hard to see the "CMU decade" 2014-2024 as having brought more ambitious EU reform than the decade following Monti's action plan from 1999 to 2009 (e.g. the adoption of International Financial Reporting Standards

⁸ Regulations [\(EU\) 2023/2859](#) and [\(EU\) 2023/2869](#), and Directive [\(EU\) 2023/2864](#).

⁹ "[Council adopts regulation easing access to corporate information for investors](#)", Council press release, 27 November 2023.

¹⁰ [ESMA page](#) on consolidated tape providers. On the 2024 legislation, see "[MiFIR and MiFID II: Council adopts new rules to strengthen market data transparency](#)", Council press release, 20 February 2024.

¹¹ Respectively, Regulations [\(EU\) 2015/760](#) and [\(EU\) 2023/606](#).

¹² Amendments to MiFIR and MiFID, regulations on prospectus and market abuse, repeal of the listing directive and a directive on multiple-vote shares. See "[Listings on European stock exchanges: Council and Parliament agree on new act](#)", Council press release, 1 February 2024.

in 2002 or the first MiFID of 2004¹³), let alone the intense financial reform outcomes of the crisis term 2010-2014 (e.g. ESMA, EMIR, MiFIR / MiFID2¹⁴).

In the specific area of supervisory integration, the 2014-2024 decade has similarly resulted in incremental rather than transformational change. In 2017, the Commission proposed new legislation dubbed the ESAs review,¹⁵ in fact an ambitious overhaul of the governance of ESMA and of the two other European supervisory authorities. But the determined opposition of some member states, particularly Ireland and Luxembourg,¹⁶ and the lack of active support from others such as Germany or Italy, ensured that the legislation finally adopted only brought marginal change in areas such as the conduct of peer reviews and breach-of-Union-law procedures. Separate initiatives entrusted ESMA with the direct supervision of third-country central counterparties and of several other limited market segments such as benchmark administrators, and providers of data reporting services.

¹³ Respectively, Regulation [\(EC\) 1606/2002](#) and Directive [2004/39/EC](#).

¹⁴ Regulations [\(EU\) 1095/2010](#), [\(EU\) 648/2012](#), [\(EU\) 600/2014](#), and Directive [2014/65/EU](#). EMIR refers to the European Market Infrastructure Regulation, an in-depth reform of EU derivatives markets.

¹⁵ Legislative proposal [COM/2018/646](#); finally enacted as Regulation [\(EU\) 2019/2175](#).

¹⁶ Bjarke Smith-Meyer, "[Finance ministers slam proposed overhaul of EU watchdogs](#)", *Politico Pro*, 7 November 2017.

2. LESSONS LEARNED

There are many lessons to be learned by the experience of the last decade as regards the CMU project. Three key takeaways are emphasized here to support a forward-looking discussion of policy prospects in the next section.

2.1. The fruits outside of financial services policy are too high-hanging for even medium-term impact

Discussions about CMU can be broadly divided into two main spaces:

- One is financial services policy in a narrow sense – roughly speaking, the turf of the European Commission’s Directorate-General for Financial Stability, Financial Services and Capital Markets Union, or DG FISMA. This space includes all the “low-hanging fruits” that Commissioner Hill attempted to harvest, and also any endeavor of supervisory integration – which may perhaps be labelled a “mid-hanging fruit”.¹⁷
- The other is a set of policies that have major implications for financial sector structures but also belong in other policy areas. These includes in particular four main themes: (1) taxation (including, but not limited to, investment taxation), which also pertains to fiscal policy; (2) insolvency legislation, which also pertains to property law; (3) rules on retirement plans, which also pertain to pension policy; and (4) mortgage finance, which also pertains to housing policy.¹⁸

The experience of the past decade suggests that these four structural policy areas of taxation, insolvency, retirement plans, and mortgage finance are unlikely to undergo significant EU-level reform just for the sake of the CMU agenda. The political salience of their other dimensions, not directly related to financial sector considerations, is too significant and too firmly anchored at the level of national policymaking for that to happen any time soon. The limited achievements so far of the Commission’s initiatives on, respectively, withholding tax procedures,¹⁹ insolvency law harmonization,²⁰ and a Pan-European Pension Product²¹ support this view. These areas of structural reform may thus be labelled “high-hanging fruits” from a CMU perspective.

By contrast, the EU has a consistent track record of impactful reform in the “core” financial services policy area, which is now widely accepted as one in which EU policy plays a major role even though national idiosyncrasies abound. This space is where the Commission’s CMU projects have had comparatively the most impact so far, as illustrated by the examples given in the previous section such as ESAP, consolidated tape and ELTIFs. It appears to offer the most significant opportunities for impactful CMU-related reform, at least in the near-term and medium-term future.

¹⁷ The author owes this variation of the fruit-picking cliché to a conversation with Thomas Moller-Nielsen.

¹⁸ The latter point has not been prominently featured (yet) in European CMU-related debates, even though it might be considered from the comparison with the United States where government-sponsored enterprises such as Fannie Mae and Freddie Mac play a major role in securities markets. The former three have been prominently included in the EU discourse about CMU, and in specific legislative initiatives as briefly developed below.

¹⁹ Communication [COM\(2023\) 324](#).

²⁰ Directive [\(EU\) 2019/1023](#) on preventive restructuring frameworks. [Regulation 2015/848](#) on insolvency proceedings was initially proposed by the European Commission before the CMU initiative, and in any case does not touch upon the actual content of insolvency law (Hallak, 2023). The Commission has published a more ambitious legislative proposal in late 2022 ([COM/2022/702](#)). As of early 2024, experts from the law firm Norton Rose Fulbright observed that the proposal “has not gained much traction and seemingly has ended up in the drawer” (Salah and coauthors, 2024).

²¹ Regulation [\(EU\) 2019/1238](#).

2.2. Supervisory architecture matters

Regulatory harmonization, namely the reduction or outright elimination of differences between regulatory frameworks applicable in the EU's different member states, has long been the mainstay of EU financial services legislation. It has made many advances, particularly over the last two decades. EU financial regulation has come increasingly close to the vision of a single rulebook, first articulated by Tommaso Padoa-Schioppa and formalized in the Larosière Report as described above. It has placed increasing emphasis on directly applicable Regulations, instead of Directives that need to be transposed into national law of the individual member states, and on a growing body of binding technical standards prepared by ESMA and the other European supervisory authorities. While many options and national discretions remain in the applicable rules, the progress towards a single rulebook has been unmistakable.

But this very progress has made it increasingly clear that a single rulebook, while necessary, is not sufficient to make a single market. Equally important is the way the rules are implemented and enforced. In the heavily regulated financial sector these processes are heavily dependent on which administrative authority is in charge. In other words, even a fully harmonized single rulebook will not lead to European market integration if it is applied inconsistently by different authorities in different member states.

The Larosière Report's response to this challenge has been to endow the new European supervisory authorities, including ESMA, with tools to foster supervisory convergence, such as binding mediation and powers to take remedial action in cases of breach of EU law – making them “supervisors of supervisors”. In addition, as previously mentioned, ESMA was also granted direct supervisory authority over limited market segments. The experience so far, however, suggests that the governance of ESMA and its sister authorities does not allow these mechanisms to operate in a satisfactory manner. Their main decision-making body is a Board of Supervisors dominated by representatives of the individual national competent authorities such as, in the case of ESMA, the *Bundesanstalt für Finanzdienstleistungsaufsicht* in Germany, the *Autorité des Marchés Financiers* in France, the *Commissione Nazionale per le Società e la Borsa* in Italy, and their peers in other member states.

Plainly, these national authorities have no incentive to deprive themselves of their decision-making autonomy by empowering the EU level, making this design of ESMA decision-making unsuited to effectiveness in fostering supervisory convergence. In otherwise, the fact that ESMA, as a supervisor of supervisors, is governed by the very entities it is meant to supervise, is inherently problematic. The same decision-making process is equally ill-suited to the limited areas in which ESMA has direct supervisory authority, if only because the activity of the supervised entities is typically not distributed uniformly in all member states. Thus, the supervisory decision can be dependent on a majority of national authorities of countries in which the supervised entity has little or no activity, an evident misalignment of incentives that is bound to hamper supervisory effectiveness.²²

A more integrated supervisory framework, with a reformed ESMA that would be both better designed and more authoritative, can be expected to have a catalytic impact on EU cross-border market integration, even though that would necessarily take time and would of course not as of itself remove

²² These considerations had already motivated the European Commission's ill-starred ESAs Review in 2017. In its 2022 report to the European Parliament and the Council on the operation of European Supervisory Authorities, a heavily redacted document, the Commission stated that it “continues to believe that the governance system of the ESAs, with decisions being taken by the 27 national supervisors, may still give too much prominence to national interests and occasionally produce sub-optimal results. In addition, this governance system sometimes makes it difficult for the ESAs to use the convergence tools at their disposal in the most appropriate way” (European Commission, 2022).

all existing barriers. That impact would come from ensuring a true supervisory level-playing field, but also from the incentives that the reformed agency would have to identify hidden obstacles to market integration and to advocate for their removal.

2.3. EU-level supervisory integration is possible

Debates about supervisory architecture in the EU, particularly on the pros and cons of pooling supervisory authority at the European level, are about as old as EU financial services policy itself. For a long time, they have felt as if such integration would only happen at a glacial pace if at all. Milestones included the creation of a conference of national insurance supervisory services as early as 1957, of a contact group of banking supervisors in 1972, of a Forum of European Securities Commissions (FESCO) in 1997,²³ the replacement of the latter by CESR in 2001, and the establishment of similar committees with no binding authority for banking and insurance supervisors in 2004. When the Great Financial Crisis started in 2007, there had been many blueprints for more integrated supervision, but also a diffuse sense that political obstacles to effective empowerment of EU-level financial supervisory authorities might be too powerful to be overcome. European Investment Bank President Philippe Maystadt, former Belgian finance minister and a seasoned observer of EU policymaking, captured that view by writing that “it is probably not realistic (at least in the foreseeable future) to expect an agreement on the creation of an EU supervisor” (Maes, 2007, page 10).

That context and perceptions, however, changed radically in the following few years. As mentioned above, the creation of EBA, EIOPA and ESMA, effective in 2011, stopped short of radical change because the effectiveness of these authorities is hamstrung by their governance arrangements (and also by their funding concept, which makes them dependent on political decisions). By contrast, the decision to establish a framework of European banking supervision (also known as the Single Supervisory Mechanism) centred on the ECB, made in mid-2012 and fully implemented by late 2014, has been a momentous game-changer. For the first time, a European-level entity has been in charge of direct supervision of systemically significant financial firms, with a governance, funding and decision-making process enabling effectiveness, independence, and credibility. European banking supervision is supported by a collaborative framework involving all national competent authorities together with the ECB, which has appeared to operate very satisfactorily so far, has experienced no observable supervisory failures, and has been correlated with material improvements in the resilience and governance of supervised banks. While few empirical studies of supervisory outcomes of this new architecture have been produced so far, those that exist tend to support the view that European banking supervision has been more demanding, independent and even-handed than the national authorities it replaced (Haselmann, Singla and Vig, 2022).

Two additional experiments of supervisory integration have followed the breakthrough creation of European banking supervision:

- First, the Single Resolution Board (SRB) was established in 2015, with a main mission to improve bank crisis management and resolution in the euro area but also “backup” supervisory authority to support that mandate. Notably, the SRB is established on the same treaty basis (Article 114 TFEU) as ESMA and its sisters,²⁴ but its governance and funding framework is very different. For executive decisions (such as designating a bank as failing or likely to fail, assessing whether its resolution meets public interest criteria, and enacting a resolution scheme), it relies

²³ FESCO itself succeeded a more informal group that had brought together the heads of most member states’ securities commissions since 1989.

²⁴ European banking supervision has a different basis in Article 127(6) of TFEU.

on a compact board of only six members. It is entirely financed by a levy on the banking industry, in contrast to the ESAs' overwhelming reliance on the EU budget and on contributions from national authorities.

- Second, legislation expected to be enacted shortly will establish a European Anti-Money Laundering Authority (AMLA), scheduled to start activity in 2025 and to assume direct supervisory authority over a subset of obliged entities later in the decade. AMLA's legal basis, governance design, and funding concept are similar to those of the SRB. Unlike the SRB, it will have direct principal supervisory authority in its field, namely anti-money laundering supervision, on a number of entities, not only "backup" authority.

Even though the SRB's framework of decision-making remains challenging and arguably requires future reform (Tröger and Kotovskaia, 2022), and AMLA is not yet up and running, these cases taken together serve as powerful proofs of concept for the feasibility of effective European-level supervision. They represent a fundamental change of context from the time when ESMA and its fellow ESAs were created, or even from the inception of the ESAs Review in 2017, when European banking supervision and the SRB were still fledgling and discussions to create AMLA had not even started.

3. POLICY PROSPECTS

With the experience of the past ten years in mind, this section focuses on the policy agenda of the next EU parliamentary term following the election in June 2024.

3.1. A sense of urgency

In 2014, the EU was in the midst of gradual recovery from the climax of the euro area crisis in early 2012. By the next election in 2019, it had had several years to absorb the traumas of the Greek aftershock of 2015 and of the Brexit referendum of 2016. In other words, none of the previous two term starts, when the incoming European Commission's policy priorities were decided, were moments of high existential stress in the economic and financial space.

In 2024, somewhat similarly, the EU is not facing an immediate critical challenge to its financial services policy framework. What it faces, however, is an increasingly intense perception of paralysis and being left behind. The banking union, Europe's most ambitious structural financial reform in a generation, remains a half-finished endeavour with no progress on the key unresolved issues – the European integration of the public safety net for banks including deposit insurance, and the regulatory treatment of sovereign exposures, to mitigate and eventually terminate the bank-sovereign vicious circle that nearly broke up the euro area in 2012. The CMU, as we have seen, has had only limited impact.

Largely as a result of this policy inertia, the European financial system is not helping as it should to facilitate the three major transitions which the EU must presently navigate.

- Green transition: the EU has experienced a major negative shock in terms of fossil fuel price following Russia's full-scale invasion of Ukraine in early 2022. Simultaneously, it has started penalizing carbon emissions. Shifting to non-carbon-emitting energy requires major investments for which the public sector is unlikely to be able to carry the entire burden.
- Technology transition: the EU remains ineffective at fostering the emergence and development of high-growth innovative companies. Its bank-based financial system is part of its competitive disadvantage to the United States for that matter, as illustrated by the numerous "flips" of promising European companies that relocate to the U.S. for better access to risk capital.²⁵
- Security transition: the sharp deterioration of the EU's geopolitical environment generates new risks. Tackling these mainly at the level of individual member states creates vulnerabilities and excessive exposures. A vivid recent example is the role of Euroclear, a globally significant financial market infrastructure but supervised at the national level in Belgium, in the matter of immobilized Russian reserve assets.

None of these concerns are sufficiently acute to force immediate decision, as happened in mid-2012 with the move towards European banking supervision. Even so, leaders may become increasingly willing to overcome the familiar obstacles of defensiveness, inertia, and special interests that have undermined meaningful EU financial system reform in the past decade. Also, the now widely shared observation that "low-hanging fruits" were not enough to give traction to the CMU project in the past decade might prompt leaders to consider a more ambitious approach.

²⁵ As one capital market participant summarized it recently, "Europe's relatively narrow and fragmented financial industry is like a weak financial heart that struggles to pump sufficient capital and liquidity to support healthy European companies and economic growth", adding that the "fragmented and more limited nature of Europe's financial sector [...] contributes to the short-term performance of European equities" even if it is not the only factor (Patterson, 2024).

3.2. Capital markets union and banking union

In this environment, financial services policymakers – including the next European Commissioner in charge of the financial services portfolio – will naturally face a choice of priorities for the coming legislative term. Perhaps the biggest apparent dilemma is between the EU’s two partial financial “unions”: the banking union, started in 2012 and only half-finished with a fully functioning supervisory arm but a deficient crisis management framework; and the capital markets union, started in 2014 but having failed so far to gain critical mass. On which of these two projects should an ambitious financial reform agenda put the most emphasis?

This is, of course, a false dichotomy. If there is reform momentum, both challenges should be tackled. There is also a high risk that nothing will happen at all. More substantially, the two projects are economically linked and, at least in part, mutually dependent (Constâncio, 2017).

In pure politically opportunistic terms, however, there may presently be an asymmetry that would justify a push for CMU revival early in the term and specifically on the “mid-hanging fruit” of supervisory integration, while the next step for banking union might require more protracted preparation. This is because a multiyear negotiation process on completing the banking union has come to an abrupt end in June 2022. One of the main missing pieces, European deposit insurance scheme, calls for a new blueprint,²⁶ as the European Commission has correctly moved away from a prior artificial separation of resolution from deposit insurance and there is growing consensus that the two must be addressed in a joined-up manner.²⁷ On the other key missing element, the regulatory treatment of sovereign exposures, the European Commission has never even published a communication, let alone a legislative proposal.²⁸ Absent a crisis, bringing these issues to a point of political decision is bound to take some time.

By contrast, it is conceivable that EU political leaders could be persuaded early in the new term to unlock the potential of CMU by taking a decisive step towards supervisory integration in capital markets oversight. The wake-up call to that effect made in November 2023 by ECB President Christine Lagarde may be an indication of a change in political atmospherics. With reference to the U.S. Securities and Exchange Commission, she said: “Creating a European SEC, for example by extending the powers of ESMA, could be the answer. It would need a broad mandate, including direct supervision, to mitigate systemic risks posed by large cross-border firms and market infrastructures such as EU central counterparties” (Lagarde, 2023).

In early March 2024, two contrasting documents indicated both that supervisory integration is potentially on the agenda, and that it would probably require political attention at the level of political principals and not merely their finance ministers. On the one hand, the ECB published a statement that built on Lagarde’s speech and called for “[i]ntegrated supervision of EU capital markets, including by ensuring [...] ESMA [...] have a European and independent governance, sufficient resources and comprehensive oversight powers, and directly supervise the most systemic cross-border capital

²⁶ It also needs a new acronym, as EDIS now stands for European Defense Industry Strategy in the EU vocabulary: “[First ever defence industrial strategy and a new defence industry programme to enhance Europe's readiness and security](#)”, European Commission press release, 5 March 2024.

²⁷ The European Commission’s 2023 legislative proposal on Crisis Management and Deposit Insurance reflects that shift. Leaving aside the fact that it is still far from adoption, however, it keeps deposit insurance anchored at the national level, in line with the political mandate received from member states in June 2022. It thus leaves the bank-sovereign vicious circle largely intact.

²⁸ To be sure, the Council has never asked the Commission to do so; but the Commission did not have a mandate from the Council either when it published its European Deposit Insurance Scheme proposal in late 2015. The issue of sovereign exposures has been the topic of numerous non-public discussions among member states from 2014-2015 until the ECOFIN meeting of June 2022.

markets actors”, adding tersely: “There are no more low-hanging fruits to pick in this [CMU] area”.²⁹ On the other hand, a statement of the Eurogroup a few days later used much more subdued language, inviting the European Commission to “assess ways to improve supervision in the EU through [...] a possible targeted strengthening of [the ESAs’] role and governance arrangements”.³⁰

Something consequential must be done to get the CMU project off the ground where it has mostly languished for ten years. A push for supervisory integration may provide exactly that.

3.3. A roadmap for markets supervisory integration

On this basis, a political initiative early in the coming term may aim at transforming ESMA³¹ into an effective EU-level supervisory authority and giving it a central role in the oversight of EU capital markets. To overcome the resistance of entrenched interests, it would need to be supported at the level of heads of state and government. As previously indicated, this would of course not instantly resolve all the problems of fragmentation and underdevelopment of EU capital markets, but the reformed ESMA could become a powerful catalyst for structural transformation.

The most straightforward option would be to start from the existing ESMA and overhaul its governance and funding framework along similar lines as those that have been adopted for AMLA. This “ESMA 2.0” should be granted a direct supervisory mandate (following a duly calibrated delay for proper preparation) over financial market infrastructures (trading platforms, central counterparties and depositories) that are significant at the European level, based on quantitative thresholds.³² ESMA 2.0 should also be empowered in key areas of enforcement of reporting requirements where cross-border consistency is needed, such as corporate financial and sustainability disclosures and derivative trade reporting, as well as possibly the supervision of major audit firms and networks to further ensure reporting consistency. The transfer to ESMA 2.0 of any supervisory authority over market participants or activities for which the application of the EU subsidiarity principle is likely to be more complex, such as investment funds, listing authorizations, and some MiFIR / MIFID authorizations, may be left to a later stage of future reform. What is important is that, in the areas in which it is given a mandate, the transfer of authority from the national to the European level should be complete, to deter any attempts by national authorities to regain turf by actions that could run contrary to supervisory objectives.³³

In at least some if not all wholesale market areas, it may be best for the framework of direct supervision by ESMA 2.0 to not rely at all on existing national authorities, as is already the case with market segments already subject to direct ESMA supervision – in contrast to the existing model of European banking supervision which relies on a hub-and-spokes scheme of cooperation between the ECB and national competent authorities in joint supervisory teams. This difference would be correlated with the fundamentally different requirements of supervision of wholesale as opposed to retail financial firms. Conversely, acute attention should be given to the risk of ESMA 2.0 becoming overly bureaucratic and losing touch with the diverse realities of the EU’s multiple wholesale financial centers. With that

²⁹ [“Statement by the ECB Governing Council on advancing the Capital Markets Union”](#), 7 March 2024.

³⁰ [“Statement of the Eurogroup in inclusive format on the future of Capital Markets Union”](#), 11 March 2024.

³¹ The exclusive focus on ESMA suggested here stems from the observation that one reason for the disappointing result of the European Commission’s ESAs Review in 2017 may have been its overly uniform approach to the three agencies, including EBA and EIOPA. Of the three, ESMA is by far the most critical for the CMU project, and singling it out for reform makes the coalition of opponents comparatively narrower than if the strengthening of all three or even two agencies is considered simultaneously.

³² Instead of mandatory direct supervision by ESMA of EU-systemic financial market infrastructure, Bank of France Governor François Villeroy de Galhau has suggested a voluntary opt-in mechanism (Villeroy de Galhau, 2024). Such a mechanism, however, may be as difficult to achieve politically as a mandatory shift, and may also lead to undesirable effects of adverse selection.

³³ To an extent, this is what is observed in the area of banking sector policy, where the coexistence of ECB authority over supervision and (still largely) national authority over crisis management and deposit insurance has incentivized the authorities of some member states to favor more ring-fencing of banks’ capital and liquidity in their jurisdiction than might be justified by purely prudential considerations.

challenge in mind and also to avoid the political downsides of geographical overcentralisation, it may be envisaged that ESMA 2.0 rely on several regional offices in the EU's main financial centres instead of ESMA's current single location in Paris. Furthermore, national authorities should remain involved in ESMA 2.0's rulemaking role along similar lines as currently in place (and as also planned in AMLA), with the setup and role of the Board of Supervisors essentially unchanged in that area.

3.4. Towards European “twin peaks”

Even if successfully implemented, the empowerment of a profoundly reformed ESMA to revive the CMU project would certainly not be the final step in the build-up of a more effective EU financial supervisory architecture. It would, however, give a sense of direction by establishing ESMA 2.0 as a major player in conduct-of-business supervision. From there, future reform over a longer term horizon could expand the agency's scope so that it would become the hub for the protection of savers, investors, and other consumers of financial services in the EU, in appropriate interaction with national authorities. The latter should obviously retain a role, by contrast to what was suggested above for wholesale market supervision, to the extent that retail financial services would be covered in the expanded scope.

Since a seminal essay authored nearly three decades ago by regulatory expert Michael Taylor, the concept of financial supervisory architecture that separates prudential from conduct-of-business oversight is generally referred to as “twin peaks” (Taylor, 1995). In this concept, financial consumer protection is the responsibility of the conduct-of-business supervisor including in relation to banks, insurers and pension funds, even though these are subject to prudential supervision by a separate authority. This architecture has been adopted, with variations, by a number of countries that include Australia, South Africa, the United Kingdom, and in the EU, Belgium and the Netherlands. It merits consideration at the EU level as a long-term objective (Schoenmaker and Véron, 2017). In such a vision, the ECB would be the EU-level (micro- and macro-) prudential authority over banks, investment firms, and possibly some payments-related financial infrastructures, complemented by the SRB as resolution and deposit insurance authority; EIOPA, the prudential supervisors of for insurance and pension funds;³⁴ AMLA, the anti-money laundering supervisor across financial and non-financial segments; and ESMA (“3.0”) the conduct-of-business supervisor for all financial firms.³⁵

This vision is very distant and likely to remain so for a very long time. Even so, a revival of the CMU project centred on the upgrading of ESMA would be a significant step in its direction. Conversely, if no progress can be made towards supervisory integration, it may be time to discard the CMU motto altogether.

³⁴ Assuming no treaty change, the ECB is legally precluded from supervising insurance undertakings. In case of opportunity for treaty change, a merger of EIOPA's role into ECB supervision could be desirable (Schoenmaker and Véron, 2017).

³⁵ Should ESMA 3.0 be given responsibility for retail financial consumer protection, it would certainly need to rely on a network of affiliates in all member states, unlike what is proposed here for a wholesale-focused ESMA 2.0. The EBA and the European Systemic Risk Board would presumably become redundant in a distant future when all EU member states have adopted the euro as their currency.

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The European Union's project of capital markets union (CMU) has disappointed in its first decade. The best way to revitalise it is to focus on supervisory integration through in-depth reform and further empowerment of the European Securities and Markets Authority. If, conversely, more integrated supervision cannot be achieved, then it may be time to discard the CMU slogan altogether.

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