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EU Financial integration and the Capital Markets Union

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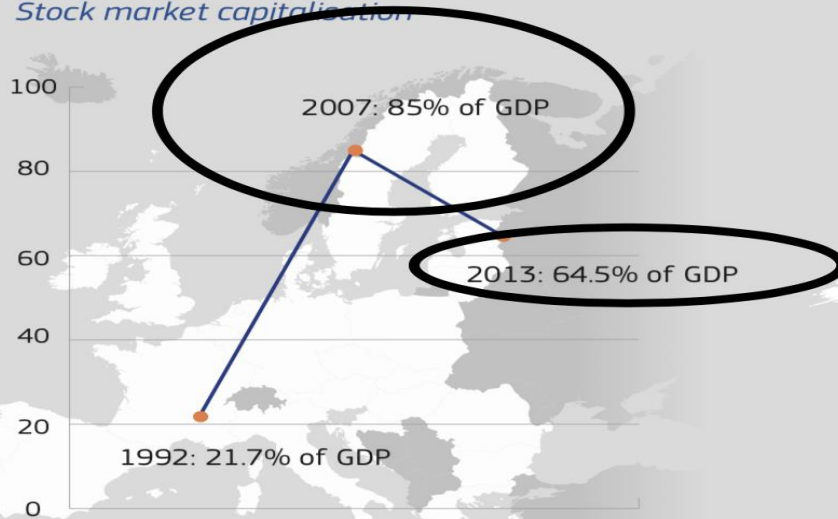
The state of the EU28 capital markets

- Underdeveloped
- Overly 'banked'
- Poorly supervised
- Small in size
- Hard to raise capital esp for SMEs

CAPITAL MARKETS IN THE EU

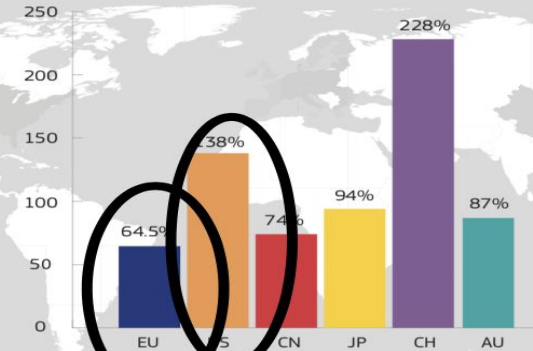
Capital markets in the EU have decreased since the financial crisis

Stock market capitalisation



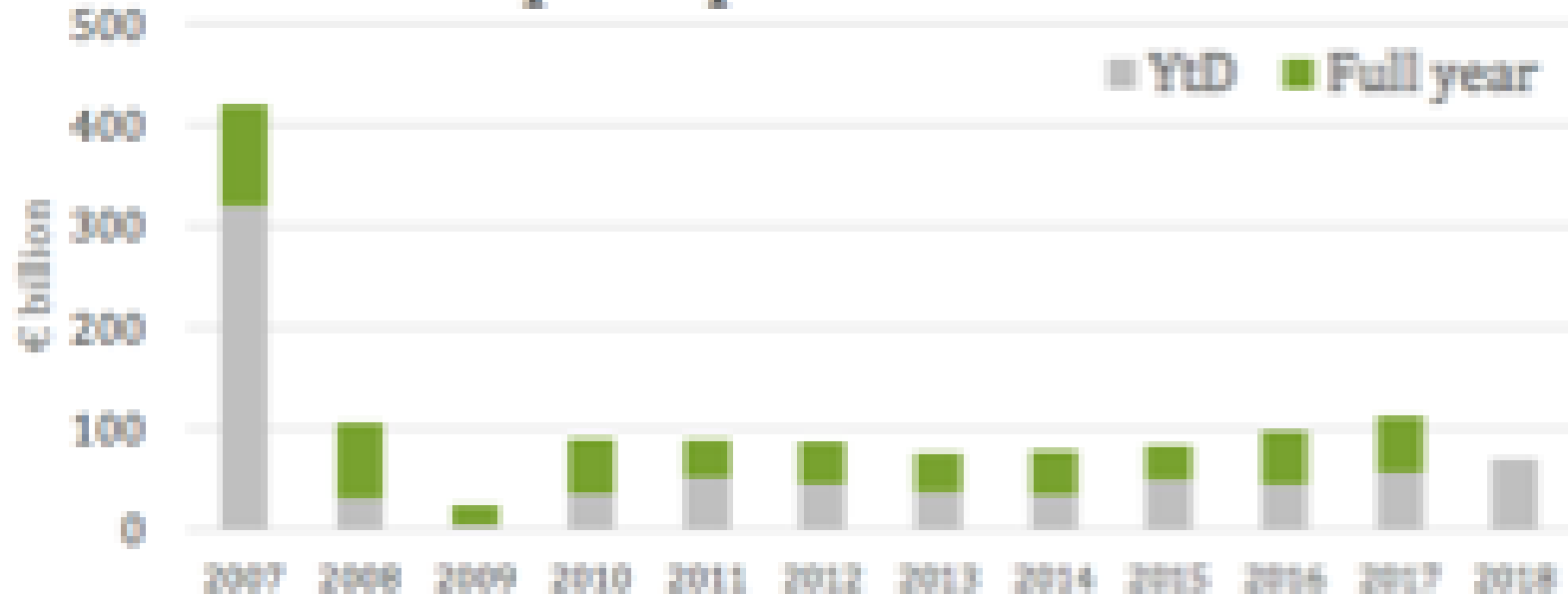
They are still smaller than in other major economies

*Stock market capitalisation (2013)**



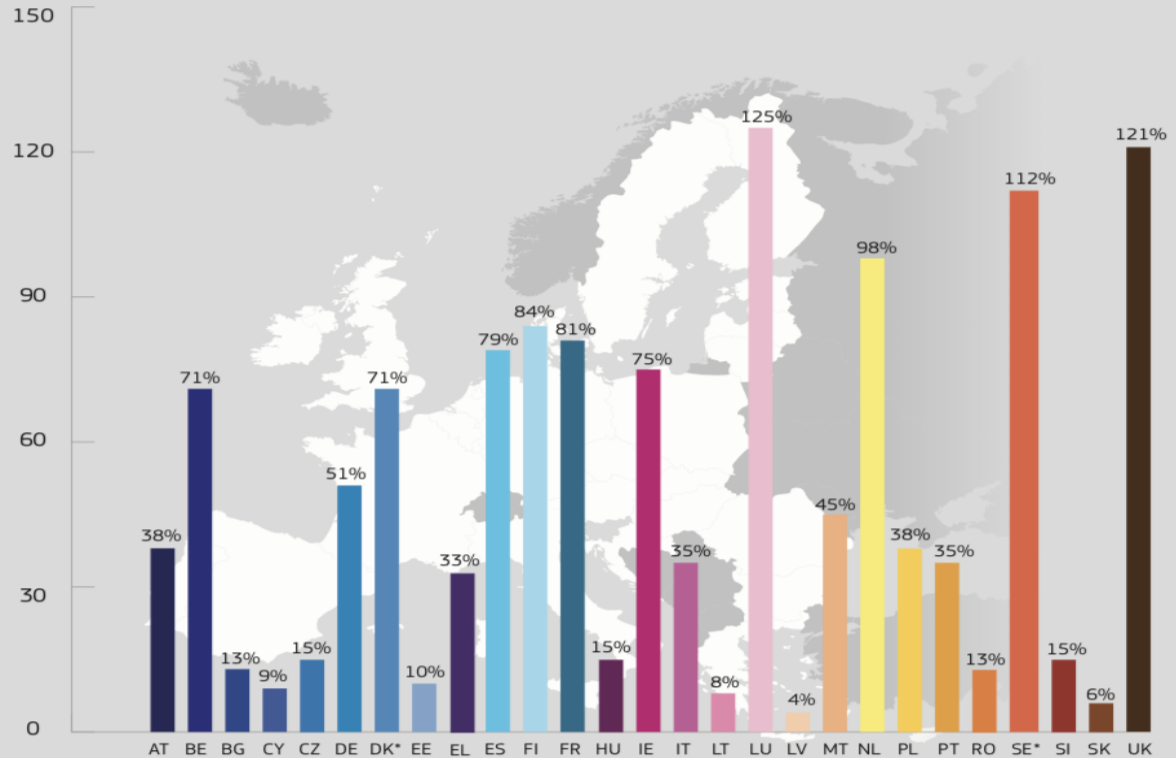
* as % of GDP

European placed issuance



And the situation in EU Member States varies greatly

Stock market capitalisation (as % of GDP) in 2013 in each EU28 country (*2012)



EU28 vs US (similar sizes)

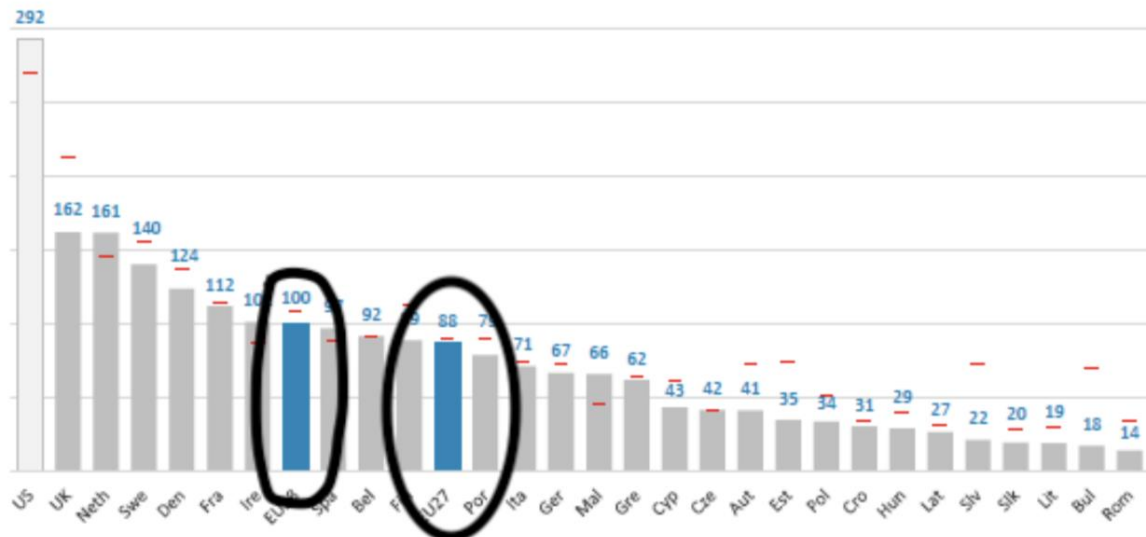
- **US CM 3x larger than EU28**
- **2006-2016: US CM growth 8%**
- **2006-2016: EU CM decline 8%**
- **EU securitization markets: 25% of US market**
- **Although by far the largest CM, London has receded most (-25%)**
- **Corporate funding: EU 2006-2016: 112%-106%**
- **Corporate funding: US 2006-2016: 134%-177%** (New Financial/Financial Times)

Fig.2 The range in depth of capital markets in the EU

The relative depth of capital markets in different countries across 24 different sectors over the three years to 2016

Rebased to EU average = 100

(note: the red markers show the depth of capital markets in each country in the three years to 2006)



Source: New Financial

Note: We have excluded Luxembourg from this analysis because the high value of domiciled investment funds relative to GDP means it is off the charts

Why such a sorry state?

- **EU has not**
 - **One currency (Sterling & EURO)**
 - **A common insolvency law**
 - **A common supervisor**
 - **A common legislator**
 - **A common cross border resolution mechanism**
 - **A common dispute mechanism**
 - **In other words; no common legal system**
 - **Passporting model compensates some, but not enough**
 - **Multiple layers of national and supranational regulatory and supervisory bodies and cultures**

The US has

- SEC
- FBI
- FED
- One market
- One currency
- Deeply integrated capital market since at least 1870
- One legal system
- One insolvency law
- One market

Banking Union (BU) and Capital Markets Union (CMU)

- **BU a financial crisis measure and a model for recent CMU proposal**
- **Single**
 - Supervisory Mechanism (SSM)
 - Resolution Mechanism (SRM)
 - Rule Book (SRB)
 - Deposit insurance scheme
 - Supervisory arm of ECB
 - AML
 - CMU + BU ==> Finance Union

The Capital Markets Union

- **2015 initiative**
- **Removing barriers between MS to cross border investment**
- **Improving access to funding for all businesses in Europe**
- **Diversifying sources of funding and reducing cost of capital**
- **Maximising the benefit of capital markets so that they can stimulate economic growth and employment**
- **Improving funding options for SMEs**
- **Internationalize**

CMU I building on 2010-regulations

- **More supranational powers to European Securities and Market Authority (ESMA)**
- **Issue guidance to national supervisors**
- **Breach of union law**
- **Product intervention**
- **Credit rating agency**
- **CCP**
- **Emergency powers**

Powers (from 2010)

- **Intervention in national markets if breach of**
 - Directive 97/9/EC (Investor Compensation Schemes)
 - Directive 98/26/EC (Settlement Finality)
 - Directive 2001/34/EC (Listing)
 - Directive 2002/47/EC (Financial Collateral)
 - Directive 2003/6/EC (MAD)
 - Directive 2003/71/EC (Prospectus)
 - Directive 2004/39/EC (MiFID)
 - Directive 2004/109/EC (Transparency)
 - Directive 2006/49/EC (Capital Requirements)
 - Directive 2009/65/EC (UCITS)
- **AND: «any further legally binding Union act which confers tasks on the Authority»**

Tasks

- (1) mere tutelage of NCAs
- (2) involvement tertiary law – ‘technical’ standards on market rules
- (3) interference in an emergency, either through binding instructions or, as a last resort, though disempowerment of a national authority in an individual case.
- ESMA then replaces a NCA and takes the decisions in its own name
- + Article 9.5-decisions: product intervention

Specific problem for Norway

- **Constitutional problems**
- **Not a member of the EU, member of EEA/EFTA**
- **Two-pillar structure**
- **Six years**
- **Approved in Parliament by necessary 75%, but covers only the CMU I-structure**
- **Example: CRA-approval and supervision**
- **Not a model for the UK**

CMU II

- **Brexit: Quit or Double Down?**
- **2017 proposal from the Commission**
- **“more integrated supervisory framework ensuring common implementation of the rules for the financial sector and more centralised supervisory enforcement is key. As stated in the Five Presidents’ Report, the gradual strengthening of the supervisory framework should ultimately lead to a single European capital markets supervisor.”**

Specific 2017 proposals

- **Capital market data:** ESMA will authorise and supervise the EU's critical benchmarks (EURIBOR)
- **Capital market entry:** approving certain EU prospectuses and all non-EU prospectuses drawn up under EU rules
- **Capital market actors:** ESMA will authorise and supervise certain investment funds with an EU label (European Venture Capital Funds, European Social Entrepreneurship Funds and European Long-Term Investment Funds)
- **Market abuse cases:** right to act where certain orders, transactions or behaviours give rise to well-founded suspicion and have cross-border implications or effects for the integrity of financial markets or financial stability in the EU

Cont'd

- **AML**
- **Insolvency directive under way**
- **Make the ESAs more independent of national interests and supervisors**
- **Ramp up funding for supervision**
 - (make the mexicans pay for it)

Push-back from the EU

- **March 2019:**
- **Vast new AML-powers to EBA: case of Danske and DK Finanstilsynet**
- **(Covered by the 2016-agreement or need to renegotiate and ask parliament?)**
- **Coordination role for the ESAs**

A EU-SEC?

- A «EULA»: EU Listing Authority can approve all listings unionwide
- Approve all prospectuses
- Be the recipient institution of all Transparency and trade reporting
- Handle all cross-border market abuse
- Sanctioning/enforcement powers for breaches of the four core directives/regulations (PR, TD, MAR, MiFID II/MiFIR)

Conclusions/final remarks

- **Brexit will make both markets worse off**
- **If Brexit:**
 - EU27 will go back to banking
 - London will lose its market to US
- **If remain:**
- **Recipe for the crisis of EU CM: US model**
 - US does not miss its Los Angeles Stock Exchange
- **Requires full-on federalisation of supervision**
- **Regulation and supervision is key to growth**