

## Capital Markets Union: A Long-Term Vision

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### Executive summary

*Capital markets union (CMU) is a welcome initiative. If well designed and implemented, it will improve access to funding, the allocation of capital, prospects for savers, and financial stability in the European Union. It can augment economic risk sharing, not least by deepening and integrating equity markets. It can set the conditions right for a more dynamic development of risk capital for young, high-growth firms that are the most important creators of new employment. It can improve returns for savers by changing saving patterns and increasing transparency. Among the three “unions” currently pursued in the European policy agenda,<sup>2</sup> this one may be the most difficult to communicate to voters, but it holds major potential for real benefits in terms of jobs, growth, and financial resilience.*

*Financial ecosystems change slowly. Their evolution depends on a complex interplay between many economic actors and the policy environment in which they operate. Shifting financial intermediation towards capital markets requires action across multiple fronts. The resulting policy agenda is correspondingly complex. It should aim at: (1) enhancing both capital markets development and cross-border financial integration, two distinct but mutually reinforcing aims; (2) increase the transparency, reliability, and comparability of information, a key enabler of trust in financial markets, which always involve information asymmetries; and (3) adequately address financial stability concerns.*

*CMU cannot be a short-term cyclical instrument to substitute for subdued bank lending. While some “quick wins” may exist and should be reaped, the real potential of capital markets union can only be achieved with a long-term structural policy agenda. This paper proposes a staged process to sustain the policy momentum and make the CMU fully worthy of its “union” label:*

- (1) an early and firm commitment on a limited number of key reforms outlined in section 4, including those in the area of accounting and auditing;*
- (2) and the set-up of several autonomous task forces to analyze and prepare policy proposals concerning the more complex issues, respectively on corporate credit information, financial infrastructure, insolvency and debt restructuring, financial investment taxation, and the retrospective review of recent capital markets regulation, with a timetable for legislative implementation before the end of the current European parliamentary term.*

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<sup>2</sup> The other two being the Energy Union and the Digital Single Market.

## 1. Introduction

**The current European Commission has created policy momentum around the idea of a capital markets union (CMU).** The expression was launched by the Commission's president, Jean-Claude Juncker, in the initial exposition of his policy agenda in mid-2014, immediately before his election by the European Parliament.<sup>3</sup> Since then, CMU has been prominently included in the title and job description of the commissioner for financial services.<sup>4</sup> The Commission published a Green Paper on CMU in February 2015.<sup>5</sup> The announcement of CMU as a policy priority has elicited a number of substantial contributions from a variety of stakeholders, both before and after the publication of the Green Paper.<sup>6</sup>

**This mirrors a broader shift in the European policy consensus.** At the outset of the financial crisis in 2007–08, European policymakers often described the bank-based nature of Europe's financial system as a factor of stability, in contrast with the more exotic features of finance in the United States, such as securitization conduits and other forms of "shadow banking." However, the dependence on banks and the scarcity of alternative financing channels have since been identified as important features of the European crisis and obstacles to its resolution.<sup>7</sup> The president of the European Central Bank (ECB) illustrated the new consensus by observing that "the crisis has shown the drawbacks of over-reliance on a bank-centered lending model. So we also need to develop reliable sources of nonbank lending, such as equity and bond markets, securitization, lending from insurance companies and asset managers, venture capital and crowdfunding."<sup>8</sup> In the debate on CMU, the reference to "capital markets" is most often used as shorthand for such sources of nonbank lending, and is preferred to the expression "shadow banking," which has more negative undertones.

**This shift is welcome from an economic policy standpoint.** Capital markets play an important role in sharing economic risks and smoothing consumption and investment. They can provide better access to funding. A well-designed CMU agenda should also make a substantial contribution to financial stability. The prior preference for bank-based finance ignored the advantages of a diverse financial system and the risks associated with the near-absence of alternative financing channels. It also led to insufficient development of forms of financing that are specifically suited for high-growth firms that are major potential contributors to European employment.<sup>9</sup> During the crisis, it acted as an obstacle against swift repair of the European banking system, and an exacerbation of sudden stops and cross-border divergences in bank funding costs.

**The debate will benefit from a clear articulation of the CMU's objective.** It is suggested here to define the CMU agenda as aiming at *enabling access by EU economic actors to the best-suited possible financing options while safeguarding financial stability*. This definition highlights major differences, in particular, with the Banking Union that is currently in a phase of implementation. Its focus is not the financial sector but the broader European economy. Stability concerns are not the primary driver, but only a check on the CMU agenda. Institutional issues are not at the core of the CMU project, even though institutional changes may be necessary to reach its aims. Its geographical scope is not centered on the euro area, but extends to the entire European Union (see below). Last

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<sup>3</sup> Juncker (2014a).

<sup>4</sup> Juncker (2014b).

<sup>5</sup> European Commission (2015a).

<sup>6</sup> See in particular AFME (2015a); Anderson et al. (2015); BlackRock (2015); Dixon (2014); European Issuers, EVCA, and FESE (2015); Goldman Sachs (2015); House of Lords (2015); Martinez and Philippon (2014); Odendahl (2015); Véron (2014); and Wright (2014).

<sup>7</sup> See e.g. Véron (2012) and Sapir and Wolff (2013).

<sup>8</sup> Draghi (2014)

<sup>9</sup> This point was developed in the precrisis context by Philippon and Véron (2008).

but not least, it is not triggered by crisis management challenges, but is part of a broader long-term agenda of structural reform at the EU level. Banks play a vital part in capital markets, even in systems where nonbank finance is comparatively more developed than in the European Union. Thus, well-designed policies for banks and capital markets can be mutually reinforcing.

**The CMU agenda connects with a long history of EU capital markets building.** Starting from the Treaty of Rome’s expression of the freedom of capital movements in 1957, major milestones on this historical path include the elimination of restrictions on capital movements in 1988; the Financial Services Action Plan of 1999,<sup>10</sup> initiated in the wake of Europe’s Economic and Monetary Union (EMU) and mostly implemented in the early 2000s; and the creation of European Supervisory Authorities (ESAs) in 2011, and new impetus given towards a “single rulebook”, following the Larosière Report of February 2009.<sup>11</sup> This historical continuity also suggests that, to deserve its labelling as a genuine “union,” the CMU agenda should go beyond the mere extension of pre-existing initiatives, even if these are important and helpful. It must envisage impactful new steps that would trigger measurable progress towards its stated objective.

**The CMU agenda is for the entire European Union.** The very notion of a single market in capital<sup>12</sup> aligns with the European Union’s internal market policy framework. Various analyses have identified specific benefits of CMU for the euro area, particularly in terms of risk-sharing.<sup>13</sup> While these benefits are an important motivation for CMU, they do not analytically imply that the project should or even could be executed at the euro area level. On the contrary, the dominance of the City of London as Europe’s capital markets hub (see next section) makes it impractical and undesirable to envisage a policy framework that would be limited to a subset of EU member states. The UK government has welcomed the announcement of CMU and signaled intent to engage actively in its shaping,<sup>14</sup> in sharp contrast with Banking Union, which it had also welcomed but on the condition of not taking part. Envisaging a CMU that would not include the United Kingdom or other non–euro area member states would be economically counterproductive.<sup>15</sup>

**As a contribution to shaping the CMU agenda, this paper suggests an analytical framework and a policy vision.** It presents facts about EU capital markets (section 2), analytical inferences for the elaboration of CMU policy (section 3), corresponding policy directions over the medium to long term (section 4), and suggestions for policy implementation and sequencing (section 5).

## **2. Assessing the European Union’s capital markets**

When analyzing financial intermediation and capital markets, three different perspectives are useful. The first is the perspective of the demand for finance from corporations, households, and governments. The second is the perspective from financial intermediaries. The third perspective is from asset owners such as savers or investors. All three perspectives are important in understanding differences in capital market structures across jurisdictions. They are equally important in identifying

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<sup>10</sup> European Commission (1999).

<sup>11</sup> European Commission (2009).

<sup>12</sup> See Coeuré (2014).

<sup>13</sup> See e.g. Anderson et al. (2015), Coeuré (2014), and Martinez and Philippon (2014).

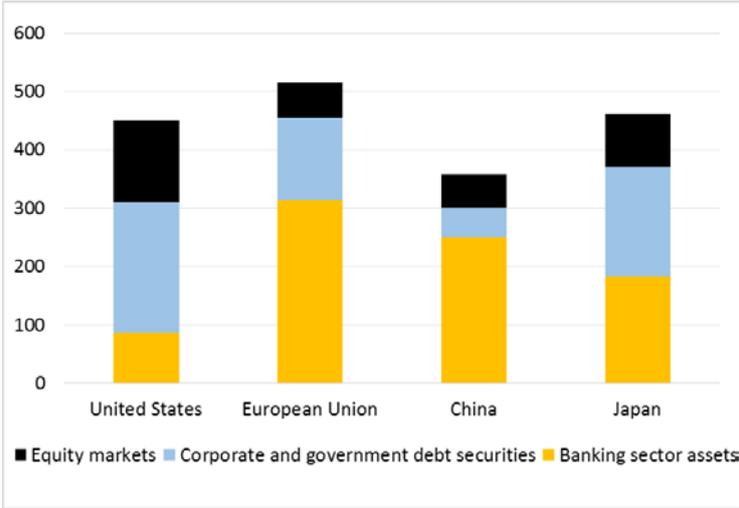
<sup>14</sup> See e.g. quote from Chancellor George Osborne in Marion Dakers, “Europe launches blueprint for capital markets union,” *Telegraph*, February 19, 2015.

<sup>15</sup> The only qualification would be about some limited aspects of the CMU agenda on which the legal basis would require unanimity, and this would not be achievable across all EU member states. Such aspects, e.g. proposals in section 4 below about taxation issues, might best be addressed through enhanced cooperation.

the policy challenges the European Union is faced with when promoting capital markets development.

**The magnitude and composition of financial intermediation are substantially different in major economic areas in the world.** Figure 1 illustrates the European Union’s large banking sector, while in the United States, debt securities and stock markets play a major role in financial intermediation. China’s financial system is still substantially smaller than the EU and US financial systems while the Japanese financial system’s structures place it between the United States and the European Union.

**Figure 1 Size of the financial sector and capital markets percent of GDP)**

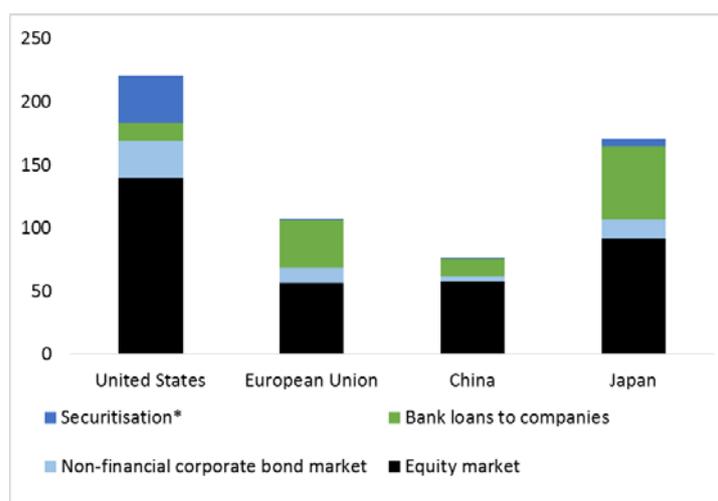


Sources: Authors’ calculations based on International Monetary Fund (IMF) *World Economic Outlook*, World Bank, Association for Financial Markets in Europe (AFME), Securities Industry and Financial Markets Association (SIFMA), Asian Bonds Online, China Banking Regulatory commission, Board of Governors of the Federal Reserve System, European Central Bank, Bank of Japan, China Statistical Yearbook, and World Federation of Exchanges.

Note: All data refer to end 2014 except for the European Union: equity market (end 2012), corporate and government debt securities (end 2013); and Japan: Banking sector assets (end 2013).

**The funding of the corporate sector is substantially different in different jurisdictions.** Only a part of the financial system serves to provide intermediation to the nonfinancial corporate sector. Beyond credit to households and the funding of government, a significant part of the financial system’s size corresponds to intermediation between financial institutions. But the way the corporate sector receives its funding is also substantially different across jurisdictions, as shown by figure 2. EU companies, like Japanese ones, rely more strongly on bank credit while their US peers rely to a greater extent on equity financing, corporate bonds, and securitization. In China, corporate credit markets remain comparatively underdeveloped.

**Figure 2 Size of financial intermediation to the nonfinancial corporate sector (percent of GDP)**



Sources: Authors' calculations based on IMF *World Economic Outlook*, World Bank, Association for Financial Markets in Europe (AFME), Securities Industry and Financial Markets Association (SIFMA), Asian Bonds Online, OPPL and Corporation, Board of Governors of the Federal Reserve System, European Central Bank, Bank of Japan, China Statistical Yearbook and World Federation of Exchanges.

\*Securitization is nonfinancial corporate sector in the United States (Commercial Mortgage backed securities) and the European Union (commercial mortgage-backed securities as well as SME securitization) and total securitization for China and Japan.

Note: Data refers to: United States: 2014; European Union: 2013, except equity market (2012); China: 2014, except nonfinancial corporate bond market (2012) and bank loans to companies (2012); and Japan: 2014.

**The structure of financial intermediation changes slowly.** The way nonfinancial corporations fund themselves tends to be stable over time (see Table 1 to Table 3 in appendix A). In the United States, for example, the percentage of equity in total corporate funding has remained almost unchanged in the last 30 years. However, bank credit has become less important and was partly replaced by securitization (see Figure 16 in appendix A). In both the United Kingdom and the euro area, equity financing has gradually lost importance, while bank lending has become significantly more important until the beginning of the crisis.

**There is substantial heterogeneity in the funding model in different EU countries.** Different EU countries have different funding models with bank lending, securitization, corporate bonds, and equity playing very different roles (see Figure 5 in appendix A).

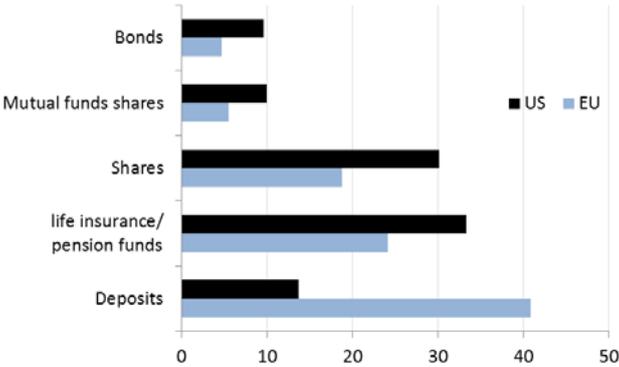
**National and cross-border financial integration of the EU financial system remains limited.** Retail banking has remained largely national with very few cross-border loans and limited cross-border ownership of subsidiaries, depending on the country (see charts in appendix A). Wholesale banking integrated substantially before the crisis but has since lost its cross-border importance. Cross-border corporate bond holdings have declined substantially during the crisis but recently have increased again. Equity markets are also characterized by a substantial home-bias.

**Capital markets can play an important role in sharing economic risk across different regions and jurisdictions.** A substantial body of literature documents that well-integrated and deep capital markets can spread country and region specific risk and thereby allow smoothing the impact of deep recessions on consumption and investment (see Figure 17 in appendix A).<sup>16</sup> Such economic risk sharing in particular requires substantial cross-border equity holdings.

<sup>16</sup> See Sorensen and Yosha (1998); Bijlsma and Zwart (2013); Allard et al. (2013); and European Commission (2015b).

**Funding models are not only determined by the behavior of corporations but also by the behavior of savers.** When savers invest significant amounts of their savings in equity, then funding with equity becomes easier for corporations. Conversely, if savers put their financial savings mostly into bank deposits, banks tend to play a larger role of financial intermediation. **EU households predominantly save in deposits while US households predominantly save in shares, life insurance, and pension funds.** Figure 3 shows that EU households save much less in bonds, stocks, and insurance than US households. Instead, they have more than 40 percent of their financial wealth in the form of deposits. Also, the level of financial wealth is very different in the European Union and the United States. As of 2012, the average household in the EU15 (EU perimeter before 2004 enlargement) held EUR 39,160 in net financial wealth, while the average US household held USD 110,227. **The different savings pattern gives banks a larger role in financial intermediation in the European Union than in the United States.**

**Figure 3: Financial portfolio of households in the European Union and the United States (percent of total financial assets)**



Source: Organization for Economic Cooperation and Development 2011.

**The different savings pattern also has important implications for maturity transformation.** In fact, the maturity structure of savings in the United States and the European Union is substantially different: US savers invest a much larger part of their savings in assets with long maturities, including equity, life insurance, and pension funds, while EU savers invest in instruments that are easily accessible such as deposits. As a consequence, the financial system has to provide different levels of maturity transformation in the different jurisdictions if it wants to achieve the same funding structure of corporates.

**Rather than small and medium-sized enterprises (SMEs) in general, it is young, high-growth companies that play the central role in EU employment creation.** It is often mentioned in policy debates that more than 65 percent of EU employment and more than 55 percent of EU value added are in SMEs (see Figure 11 in appendix A). But it is even more important that young firms, as opposed to older companies, are the true engines of job creation. According to OECD research, around 50 percent of all new jobs are created by young firms, and these young firms have always been net job creators throughout the business cycle (with high-growth firms playing the most important role), even during the financial crisis.<sup>17</sup> Hence, if generating employment is a key goal, the financing and growth of such young, high-growth firms is a central challenge for the European Union.

**Most SMEs will keep relying on bank funding, but securitization and nonbank credit could play a greater role to improve funding of the larger ones.** The role of SMEs in capital markets is minimal. They predominantly rely on bank lending for their funding. To the extent that bank lending is a

<sup>17</sup> Criscuolo et al. (2014).

constraint because of limits to banks' balance sheets, securitization could free up additional lending. The securitization market for SMEs is particularly strong in Spain and Italy. However, it serves more the purpose of creating assets eligible in collateral operations of the ECB than freeing up banks' balance sheet capacities. Most of the newly issued securities are retained (see charts in appendix A). Developing a more dynamic market for creating and placing SME credit as securities could be a helpful avenue to improve funding for SMEs. Realistically, however, this would only make a difference for a minority of larger SMEs, given the idiosyncratic nature of SME credit risk and the cost of documenting securitization. Beyond securitization, service innovators that do not have tangible collateral to pledge need access to high-risk forms of credit such as mezzanine and high-yield debt, which are typically not offered by traditional banking.<sup>18</sup>

**Financial services tend to concentrate in financial hubs.** In the European Union in particular, wholesale financial activity is already highly concentrated in London, and if anything, the recent years of crisis appear to have accelerated such concentration as they have forced banks to restructure their less efficient activities. A recent survey suggests that 77 percent of highly-paid financial executives in the European Union are based in the United Kingdom; the next most significant group is in Germany, representing only 6 percent of the total.<sup>19</sup> Similarly, the share of the United Kingdom in the total of derivatives transactions in the European Union has risen from 61 percent to 77 percent in the 15 years to 2013 (London's share in the global total has also risen during this period, from 33 to 43 percent). As of 2013, the next largest number in the European Union is in France, at only 7 percent of the EU total.<sup>20</sup>

### 3. Analytical takeaways

**As the structure of financial systems changes slowly, CMU cannot be taken as a “quick fix” substitute for repairing the bank-lending channel where still needed.** To revive economic growth and investment in the short term, policymakers are right to rely on monetary policy action by the European Central Bank, including the quantitative easing program started in March; on the work by the European Single Supervisory Mechanism and Single Resolution Board to repair banks' balance sheets and achieve a return of trust to Europe's banking sector; and on initiatives to boost investment, such as the Juncker investment plan at the EU level and national confidence-building measures. Even though an assessment is not within the scope of this paper, these actions all hold potential to help with growth and job creation in the short-term. By contrast, hopes that CMU would play a meaningful role in EU economic recovery from the crisis are likely to be disappointed.

**CMU should be designed and thought of as structural and long-term transformation of financial intermediation in the European Union.** It cannot serve as a short-term stimulus to boost finance. Rushing it through subsidies or tax or regulatory privileges will be distortive and ultimately counterproductive and should be avoided. What counts is to create the right framework conditions for a new financial ecosystem to develop at its own pace, which will be gradual.

**The two objectives, of enhancing capital markets development on the one hand, and of fostering cross-border financial integration on the other hand, are distinct and may require different policies.** Europe's financial system can be characterized by two fundamental features. On the one hand, capital market finance is comparatively underdeveloped in most countries given their general

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<sup>18</sup> This point is further developed in Philippon and Véron (2008).

<sup>19</sup> European Banking Authority (2014).

<sup>20</sup> Authors' calculations based on the Triennial Central Bank Survey of foreign exchange and derivatives market activity in 2013, available at <http://www.bis.org/publ/rpfx13.htm>.

level of economic development. On the other hand, financial markets still remain predominantly national, as measured by high home bias in investment patterns. The two issues are linked but call for different policy responses. While the former is more about improving conditions for capital market intermediation in every country, the latter is about harmonizing and standardizing the rules and practices of financial intermediation across countries.

**CMU should combine the benefits of deepening and integrating financial markets.** Both are beneficial and mutually reinforcing. Integration across borders, not least in equity markets, brings economic risk mitigation and reduces the financial-sovereign vicious circle. It also increases competition and allows for scale effects, which should help to generally reduce funding costs. This integration will also contribute to the development of markets. Deeper capital markets, in turn, offer a greater variety of funding options and easier access to finance for different kinds of corporations. They also increase the options for households to save and invest.

**Most SMEs will remain reliant on banks for their external funding and will not be directly affected by CMU. However, CMU should have material impact to broaden financing options for high-growth companies of all sizes and dynamic medium-sized firms.** It is misleading to characterize CMU as a project to target primarily SMEs. SMEs will continue to rely predominantly on banks, even though the larger ones may gain capital market access through better-developed corporate loan securitization. Large corporations already have decent access to capital markets. Where CMU has the most potential is high-growth companies, which lack access to risk capital<sup>21</sup> and medium-sized ones, which currently have much more limited access to capital markets than large groups.

**To change financial intermediation towards capital markets, the perspectives of savers, financial intermediaries, and nonfinancial firms are all important.** The shape of the financial ecosystem depends on decisions of all three categories of actors and framework conditions that affect them. Changes in the funding mix for nonfinancial corporations have implications for financial intermediaries as well as for savers. For example, strengthening equity funding implies that investors need to accept taking higher risks and longer maturities. While the current pattern of European savings in low-risk, short-maturity instruments is probably rooted in preferences and demographic structures, it is also encouraged by specific tax and regulatory policies. These policies should be amended to meet the objective of better funding for the European economy, including through equity instruments. Similarly, corporate governance and ownership patterns that are dominated by family control in several EU member states may contribute to companies' reluctance to tap external sources of finance and especially those outside banks, but a more favorable policy framework may incentivize a significant number of companies to change their financing patterns in a manner that would be more conducive to investment and job creation. Financial intermediation and in particular banks are also central. Banks perform important functions in terms of maturity transformation, financial engineering, the overcoming of information asymmetries, and they have the capacity to deal with regulatory and supervisory differences across countries. Increasing harmonization across EU countries could allow other actors or even savers to engage directly in cross-border activity more easily. However, this also means that other actors take certain risks, including in terms of maturity transformation.

**Deeper and more integrated capital markets should spread economic risks, but potential financial stability risks need to be managed.** The economic literature and the empirical evidence are clear that financial integration is a good way of spreading economic risks. But the emergence of new financial players also raises financial stability concerns, especially when they engage in maturity transformation and/or financial engineering. There are risks at the level of instruments, institutions,

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<sup>21</sup> Veugelers (2011).

and the system. While not identical to those from banking, financial stability risks from capital markets and nonbank finance need to be adequately monitored and, if necessary, mitigated through appropriate regulation. Thus, **financial stability considerations should be an integral part of CMU.** This raises questions as regards regulation, supervision, and resolution and the allocation of these tasks to relevant institutions.

**To achieve a different pattern of household investment, savers protection is fundamental.** Households and savers will only invest in financial products if transparency is given and they comply with clear and reliable rules. Deposits in the European Union enjoy the extraordinary privilege of a high deposit insurance guarantee. By contrast, other forms of financial investment not only have much more limited protection if any at all, but are also often opaque and difficult to understand. Adequate safeguards for savers and investors should therefore be an important part of CMU and may require a strengthening of both legislation and supervision. At the same time, consumer protection needs to be adequately calibrated in order not to stifle risk taking and innovation.

**All member states will gain from better access to finance and better returns for savers, even though some will host more financial sector activity than others.** In an integrated market, financial firms and actors tend to concentrate in a limited number of locations, especially in wholesale market activity. The US financial system, for example, is dominated by the role of New York and a few other spots such as Boston, Chicago, and the San Francisco Bay Area. Yet Texas or Ohio can still prosper without a capital market of their own, or even locally-headquartered large banks. There are only three stock exchanges in the United States, as opposed to 13 in the European Union.<sup>22</sup> Similarly, CMU does not mean that all member states have to gain in terms of the development of their own financial services sector. On the contrary, comparative advantage should be allowed to play. From this perspective, CMU would have a distributional impact among EU member states given their differential strength of comparative advantage in financial services. This distributional impact of CMU, however, should not shift the attention from its more significant impact on nonfinancial corporate funding and improved saving opportunities, which would be positive in all member states even though their magnitude would vary. Local financial ecosystems now work through private equity and investment communities, not local financial infrastructure such as stock exchanges. CMU should be allowed to disrupt currently protected national infrastructure platforms and other entrenched financial market structures to reap efficiency gains.

#### 4. Policy Agenda

The following policy recommendations are based on the analytical framework presented in the previous section and on the current stage of capital markets policy development in the European Union. They also follow extensive discussions with a wide range of stakeholders<sup>23</sup> and review of

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<sup>22</sup> Based on membership of the Federation of European Securities Exchanges (FESE) and the World Federation of Exchanges (WFE). These groups are, respectively, BATS, Nasdaq, and the New York Stock Exchange (part of ICE) in the United States; and the stock exchange groups headquartered respectively in Amsterdam (Euronext), Athens, Bucharest, Bulgaria, Cyprus, Frankfurt (Deutsche Börse), Ireland, Luxembourg, Madrid, Malta, Stockholm (part of Nasdaq OMX), Vienna (CEE Stock Exchange), and Warsaw in the European Union. This list does not include the separate stock exchanges in Bratislava and Zagreb, which do not appear on the FESE membership list.

<sup>23</sup> These have included a brainstorming workshop held at Bruegel on November 24, 2014; a presentation by the authors at a meeting of the EU Financial Services Committee on January 20, 2015; the authors' and their Bruegel colleagues' participation in a range of conferences and other events organized by third parties in a number of different EU member states; and numerous bilateral conversations with interlocutors in academia,

available surveys and evidence. It is not implied that all of the following items must be delivered in full for the CMU to be a long-term success, nor indeed that this list is exhaustive—other significant initiatives may be needed, possibly in the wake of new technological developments. Nevertheless, these items all appear important to reach the aims of the CMU agenda as expressed by the European Commission and tentatively defined in this paper’s introduction.

**System-wide Surveillance.** Most EU member states have a long tradition of monitoring risks in their national banking system. In the euro area, the implementation of Banking Union offers the prospect of much-improved supranational banking risk monitoring. However, the surveillance of a more complex financial system in which the role of banks may gradually become less dominant implies new challenges, which call for an adequate infrastructure.<sup>24</sup> This echoes legitimate concerns about “shadow banking” and the possibility of financial risks migrating to parts of the financial system where they might escape public monitoring. New initiatives are needed both in terms of data collection, which currently tends to be fragmented across different systems, and in terms of institutional architecture, a particular challenge given the strong interdependencies between the euro area (which accounts for a majority of the EU’s economy), the United Kingdom (which hosts the main hub of EU capital markets), and other non-euro area member states. One solution might be to **beef up the capacity of the European Systemic Risk Board (ESRB)** to collect and analyze granular data and thus to bring Europe closer to the vision of a holistic real-time “risk map”,<sup>25</sup> in conjunction with efforts led by the Bank for International Settlements (BIS) and Financial Stability Board (FSB) at the global level.

**Financial Product Regulation.** In the wake of earlier efforts to move towards a single rulebook for capital markets regulation, the European Union should continue to work towards a clearly articulated, simple and effective regulatory framework for those financial market activities that cannot be simply left to the discipline of the markets. This should include the completion of projects that have already been announced or are at various stages of elaboration by the European Commission and other EU institutions, including on European Long-Term Investment Funds (ELTIFs),<sup>26</sup> securitization,<sup>27</sup> the revision of the Prospectus Directive,<sup>28</sup> and private placements.<sup>29</sup> It should also include additional initiatives such as a revision of the EU framework for Undertakings for Collective Investment in Transferable Securities (UCITS), the reference fund status for retail investment in the European Union, in order to enable direct investment by UCITS in loans originated by banks, as the current curbs on such investment appear excessive from the standpoint of either financial stability or investor protection. The European Union should also further replace directives with regulations to close loopholes, reduce national “gold-plating” (the addition of idiosyncratic national provisions in the legislative transposition of EU directives) and ensure pan-EU regulatory consistency. Such regulatory actions form the bulk of the concrete policy actions described in the European Commission’s white paper on CMU. It should however be kept in mind that while

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the public policy community, the private sector, and other segments of European civil society. The authors are also grateful to all those who have given feedback on early drafts of this paper.

<sup>24</sup> Among others, Wright (2014) notes that “there is a striking inconsistency in data in some parts of the [EU] capital markets.”

<sup>25</sup> See e.g. Issing and Krahen (2009).

<sup>26</sup> The European Commission published a legislative proposal on ELTIFs in June 2013, which is currently going through the EU legislative process.

<sup>27</sup> A consultation is currently underway on “simple, transparent and standardised securitisation” (European Commission, 2015c).

<sup>28</sup> On this too, a consultation was launched at the time of publication of the CMU Green Paper (European Commission, 2015d).

<sup>29</sup> See a proposal outline for a harmonized single EU private placement regime in Houmann and Gleeson (2015).

necessary, they are far from sufficient to enable significant development and integration of EU capital markets.

**Regulation of financial entities.** In addition to the regulation of financial products and activities, many financial firms are subject to a specific regulatory, supervisory, and in some cases resolution framework that impact their role in the development of EU financial markets. Concerns for financial stability, given the specific nature of financial systemic risk, and/or for financial conduct, not least because of the multiplicity of information asymmetries that exist in finance, generally motivate such regulation. In this respect, currently examined legislation on **Banking Structural Reform** is of particular importance. The detailed analysis of this proposal is beyond the scope of this paper. However, it appears appropriate to take into account the CMU's objectives of capital markets development in the legislative discussion and finalization of this text. Other significant bank-related regulatory projects with important implications for capital markets include further EU implementation of the global Basel III Accord, and the future EU transposition of the forthcoming global standards on banks' Total Loss-Absorbing Capacity (TLAC). EU legislators may contemplate delaying the completion of the Banking Structural Reform legislation to incorporate closely related TLAC concerns into it.

Aside from banks, **insurers** are crucial participants in European capital markets as investors. The ongoing implementation of the new Solvency 2 regime should be completed in 2016 as currently planned, to minimize regulatory uncertainty. However, this package deters investment by insurers in riskier market segments such as equities, under a framework that is largely inspired by the prudential regulation of banks and does not adequately take into account the longer maturities of insurance liabilities. EU legislators should consider its rapid review in order to achieve a better balance between the need to maintain the long-term solvency of insurers and the concern not to unnecessarily hamper their potential as long-term risk-taking investors in the European economy. Also, the European Union may consider adjustments to regulations that were adopted in the heat of the crisis, e.g., those on alternative investment funds and on credit rating agencies, in order to take into account the experience of their early implementation's impact on EU capital markets activity.

One category of intermediaries that European policymakers have often tried to actively promote is **Venture Capital (VC) funds**. The development of VCs is seen as desirable, as it is associated with high-growth technical innovators. However, the record of policies aimed at stimulating VC development through provision of public money, either in the form of public VCs or coinvestment of public funds with private-sector VCs, is not compelling. The main reason is that the control mechanisms that are inherent in any use of public funding easily enter into conflict with the high-risk, high-return logic of VC investment, including the way VC investments are chosen, and even more so the way they may be discontinued when the invested company is not sufficiently successful. In addition, the injection of significant amounts of public money into comparatively small VC markets in individual member states has often led to market and price distortions that have ended up penalizing rather than helping the savvier VCs. Thus, the EU should refrain from throwing public money at the VC market, including through the European Investment Fund (EIF). The best way to encourage a vibrant European VC industry is to work on their investment environment rather than interfere directly with their activity. The policy proposals in the following items would contribute to such an approach, as they focus on the framework conditions in which capital markets can develop.

**EU-level regulatory implementation and enforcement.** Overwhelming evidence from market participants suggests that the current regime of national implementation and enforcement of even the most harmonized EU regulations results in diverging practices and market fragmentation. Economic actors cannot simply transpose their experience of regulations in one member state to

another, and need country-specific legal advice in each member state. In a recent survey, investors cited the complexity of such differences across national markets and the discrepancies in rules (resulting from national rules and from gold-plating of EU ones) as the two most important barriers to investment in the European Union.<sup>30</sup> The creation of the European Securities and Markets Authority (ESMA) in 2011 provides an existing infrastructure for the implementation and enforcement of EU legislation in a consistent manner across the European Union, but it needs to be further empowered to act as an effective regulator as opposed to a weak coordination mechanism. The chairman of ESMA recently noted that “given the breadth and complexity of the single rulebook, regulators need to make many choices regarding their supervision, including the interpretation of the rules and the intensity of supervision. Diversity in these choices will have the result that the single rulebook will not in fact be seen as such by investors and market participants.”<sup>31</sup> A decision of the European Court of Justice in 2014 has provided additional legal security on the granting of authority to ESMA on matters of capital markets regulation,<sup>32</sup> and ESMA is already the sole supervisor for certain categories of capital market participants that include credit rating agencies and trade repositories.

Specifically, the **authority to approve new securities issuance and to authorize funds** under legislation such as UCITS and AIFM may be transferred to ESMA, with a transfer back to national authorities of much of the actual regulatory work but as part of a binding EU network where ESMA would hold effective policy control.<sup>33</sup> Other policy areas, such as EU competition policy and (in the euro area) the prudential supervision of banks within the Single Supervisory Mechanism, provide examples of such patterns of delegation that ensure both regulatory consistency and a large degree of operational decentralization.

Similarly, the **enforcement of EU capital markets regulation** should be at least partly pooled at the level of ESMA with wide operational delegation back to the national authorities, in order to ensure that sanctions for non-observance are not simply evaded by market participants by moving their activity from stricter to more lenient EU jurisdictions (a practice often described as “forum-shopping”), e.g. on rules related to securities issuance and investor protection. Similarly, obligations related to systemwide risk monitoring, including the requirement to report derivatives transactions to central repositories, are currently enforced very heterogeneously across member states, and a transfer of enforcement responsibility to ESMA would result both in lower costs and in much improved compliance. The possibility of coexistence of national and European enforcement regimes should be carefully assessed, but must not be considered an intractable problem per se, as is illustrated by the longstanding situation in the United States where federal and state-level enforcement frameworks operate simultaneously, especially in states with significant financial activity such as New York. In parallel, the Commission should be more assertive in its own role of single market enforcement through infringement procedures where needed, in cases of national legislation that is not compliant with the EU framework.

Of course, such regulatory centralization would require decision making at the adequate political level, as was the case when the decision to create ESMA and the other ESAs was made in June 2009. It would also probably entail reform of ESMA itself. Some of the related challenges are further discussed in section 5.

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<sup>30</sup> AFME (2015a), Figure 1.

<sup>31</sup> Maijoor (2015).

<sup>32</sup> Judgment of the Court on case C-270/12, *UK v. Parliament and Council*, January 22, 2014, analysed e.g. in Pelkmans and Simoncini (2014).

<sup>33</sup> Both proposals, referred to as a “European System of Listing Authorities” and a “European System of EU Fund Approval” respectively, are in Houmann and Gleeson (2015).

**Accounting and Auditing.** Financial information has been justifiably described as the lifeblood of capital markets,<sup>34</sup> and the availability of high-quality and comparable financial information on issuers across the European Union is a crucial condition for the success of CMU. The EU adoption of International Financial Reporting Standards (IFRS), decided in 2002 and implemented in 2005–06, has been a huge step in this direction, but more needs to be done. There remain wide differences across member states in IFRS implementation and enforcement and in other aspects of financial disclosure. This item includes elements of the previous three, as it should include reform of the regulation of auditing practices and of audit firms, and a pooling at the European level of the supervision of auditors and of the enforcement of IFRS in the European Union.

First, the responsibility for IFRS enforcement should be granted to a newly created **office of the European Chief Accountant** (in reference to the equivalent authority in the United States, which is hosted by the Securities and Exchange Commission). This office, which could be envisaged either as part of ESMA or as a new organization, would be given functional authority over the existing national competent bodies<sup>35</sup> for purposes of IFRS implementation. Second, the numerous loopholes that exist in the EU auditing legislation (including after its latest revision in 2014) should be closed to constitute a genuine single rulebook, and **the supervision of audit firms should be pooled** from the national to the European level in a specialized agency that may be itself subject to oversight by ESMA (in a relationship similar to that between the US Public Company Accounting Oversight Board and the Securities and Exchange Commission). Third, the European Commission should further explore the costs and benefits of reforming accounting obligations that are not currently within the scope of IFRS, namely the financial statements of individual entities and of unlisted companies. While there might be a case for harmonization,<sup>36</sup> this should be robustly assessed on the basis of the subsidiarity principle. It should also be considered in liaison with proposals to reform corporate taxation, as tax accounting is one of the main drivers of non-IFRS financial reporting in many if not all EU member states: A move towards harmonization of the corporate income tax base would have obvious spillovers in terms of harmonization of single-entity accounting requirements.<sup>37</sup>

**Corporate Credit Information.** In complementarity with financial information covered by accounting and auditing frameworks, information about corporate risk and credit is similarly important in order to stimulate market-based investment. Even though situations vary across member states, capital market participants other than banks and central banks currently have only limited access to credit information on SMEs and even on many large companies in the European Union (aside from the limited number of those that are rated by credit rating agencies). The European Commission has initiated work on improving the availability and quality of such information, as is announced in the CMU Green Paper. But this raises complex issues of confidentiality and market structure and should also be connected with the ambitious ECB project of building an analytical credit dataset (known as AnaCredit), which would also cover a large part of the SME credit landscape.<sup>38</sup>

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<sup>34</sup> See e.g. Levitt (1999).

<sup>35</sup> Depending on national circumstances, these are currently either accounting enforcement units within securities regulators (as in France, Italy, the Netherlands, and Spain), or hosted by other specialized public authorities (e.g. the Financial Reporting Council in the United Kingdom), or private-sector bodies empowered by law (e.g. the Financial Reporting Enforcement Panel in Germany).

<sup>36</sup> For example, Maijor (2015) argues that “we should consider moving to a common accounting language for SMEs that would like to grow and get a broader investor base. That language should be based on IFRS but not as extensive as the standard set of IFRS.”

<sup>37</sup> It should be noted, however, that the current EU project for a Common Consolidated Corporate Tax Base (CCCTB) would be only an option for companies, and its adoption would thus not have obvious impact in terms of accounting frameworks.

<sup>38</sup> See e.g. Damia and Israël (2014).

**Financial Infrastructure.** As noted in the previous section, the European landscape for trading and post-trading infrastructure is marked by extraordinary complexity and fragmentation. This is due in large part to the complex legacies of past national systems and also to the lingering symbolic potency of stock exchanges as emblems of national economic strength and sovereignty. In the early 2000s, the European Commission fostered a strategic review that resulted in two landmark reports by a group chaired by Alberto Giovannini, and identified 15 “Giovannini barriers” to efficient cross-border clearing and settlement in the European Union. Even after initiatives that include the adoption in 2014 of a new EU Regulation on Central Securities Depositories and the creation by the ECB of the T2S (Target2Securities) platform for securities settlements, many of these barriers still remain.<sup>39</sup> As identified in the Giovannini reports, the European Union should aim at reducing or eliminating the current difference between cross-border securities transactions and transactions within a single EU country. The specific but systemically important challenge posed by the prudential supervision of derivatives clearing houses (known in the European Union as CCPs, or central counterparties) is discussed in the next section.

**Insolvency and financial restructuring frameworks.** A growing literature has identified insolvency law and debt restructuring practices as major determinants of corporate credit.<sup>40</sup> In the European Union, the understanding of this issue has been recently enhanced by observation of significant insolvency reforms in countries under assistance programs, such as Ireland. A better insolvency framework allows for a better reallocation of capital and more growth. In many EU member states, inefficient and antiquated frameworks for insolvency and debt restructuring act as deterrents against corporate investment and high-risk segments of credit (such as mezzanine and high-yield debt), since investors and creditors are insufficiently protected in insolvencies, and the conduct of the insolvency process is far from maximizing the prospects for asset recovery. Additional inefficiency arises from the lack of consistency of insolvency provisions across borders, but the first-order issue appears to be the inadequacies of national insolvency frameworks themselves, in terms of both the law itself, and the way it is implemented through courts and the work of specialized service providers and professions. In this area, full harmonization is unrealistic even over a long-term horizon, given deeply embedded differences in national legal frameworks. However, the European Union could stimulate a coordinated reform process across member states with common principles and harmonization of a limited set of relevant aspects,<sup>41</sup> with appropriate benchmarking and monitoring at the EU level. In parallel, the creation of a specific EU insolvency regime for banks, administered by an EU court, appears indispensable in the medium term to complete the legal framework of Banking Union and especially the vision of a Single Resolution Mechanism.

**Taxation of savings and investment.** Since taxation always acts as a key driver of investor behavior, differences in frameworks for the taxation of savings are a contributor to market fragmentation and to the difficulty of creating powerful, simple, pan-European market segments for investment. In many member states, tax frameworks also contribute to the orientation of savings towards low-risk, short-maturity instruments. Because EU-wide unanimity is likely to be unattainable, joint projects for the taxation of savings could be envisaged by subsets of member states using the enhanced cooperation procedure. This procedure has already formed the basis for the initiative to create a European Financial Transactions Tax (FTT), but unfortunately this project still appears ill-designed. If

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<sup>39</sup> See in particular <https://www.ecb.europa.eu/paym/t2s/about/about/html/index.en.html> and <https://www.ecb.europa.eu/paym/t2s/about/html/giovannini.en.html> for a description by the ECB of the complexity of clearing and settlement, the Giovannini barriers, and the expected impact of T2S.

<sup>40</sup> See e.g. Djankov, McLiesh, and Shleifer (2007); Davydenko and Franks (2008); and Plantin, Thesmar, and Tirole (2013).

<sup>41</sup> See a recent set of proposals in AFME (2015b).

it were to be adopted, it may act as a brake on investment, with detrimental economic consequences. European member states should instead focus their energies on harmonized taxation of savings, reforming the tax disadvantage given to equity relative to debt, as well as other initiatives that could stimulate investment and market development.

**Possible further items.** As mentioned above, this list is not intended as exhaustive. In particular, reforms of pensions and housing policies may have very significant impact on capital markets, say with the creation of pan-European pension fund systems or covered bond markets. However, these would have social and political implications that would go far beyond capital markets development concerns. Consequently, they are considered here outside of the policy remit of the CMU agenda. However, CMU-related aspects may usefully be considered in future discussions about them.

## 5. Implementation and Sequencing

**Maintaining the momentum.** A welcome momentum on CMU as a high-level priority for the entire European Union has been created. It is important to maintain this momentum through adequate calibration and sequencing of future actions. The delivery of “quick wins” on ongoing projects of financial product regulation (ELTIFs, securitization, prospectus directive, and private placement) is important in this regard. However, these will be no substitute for more ambitious initiatives with transformative long-term impact that would justify the “union” label. CMU, if ambitiously executed, can eventually deliver tangible benefits to EU citizens in terms of more jobs, growth, and a more stable financial system. The challenge will be to keep the policy momentum despite the structural nature of the effort and the technical nature of the project, which makes it difficult to explain to broader audiences. Fortunately, the new EU policy consensus, which recognizes the need for stronger capital markets as a way to make the financial system both more efficient and more resilient, is supportive.

At the same time, the political and technical obstacles should not be underestimated. Given the complexity of some of the issues listed in the previous section, it is not realistic to expect a detailed blueprint on all of them by the time the Commission is expected to publish a CMU action plan in the second half of 2015.

**Staged Process.** As a consequence, the Commission’s Action Plan may combine, on the one hand, firm policy announcements that demonstrate commitment, and on the other hand, the launch of processes for further study on the most difficult and complex items listed above.

**The area of accounting and auditing may be judged particularly promising** for a firm policy announcement later this year, especially the two main proposals outlined in the previous section on IFRS enforcement and audit regulation and oversight. The need for high-quality comparable information across the European Union can hardly be disputed as a precondition for CMU; there is near-universal recognition among financial practitioners that the current policy framework does not achieve this aim; the European Union can capitalize on the successful adoption of IFRS a decade ago to claim legitimacy in this area; and reform is made more urgent by the need for cross-border accounting and auditing consistency in the euro area to support the operation of Banking Union. Early commitments would also be desirable on other proposals made in the previous section, such as on system-wide monitoring, listing authority, fund approval, and enforcement.

To tackle the most complex areas, the European Union could create **parallel processes of analysis and elaboration of policy proposals**, on the following five areas: corporate credit information; financial infrastructure; insolvency and debt restructuring; financial investment taxation; and the

retrospective review of the aggregate impact of capital markets regulation passed in the last decade, echoing the intent signaled by the Commission to undertake this type of retrospective analysis.<sup>42</sup> Given the complex and technical nature of these topics, and also the fact that they span the remit of several European Commissioners and Directorates-General within the Commission, it would be advisable to **entrust autonomous task forces with the analysis and the elaboration of corresponding policy proposals**. Their specific design and governance may vary across issues and should take consideration of past processes deemed successful.<sup>43</sup> The Action Plan should also set target dates for these task forces to deliver detailed policy proposals, say in late 2016 or early 2017, so that subsequent legislative implementation could be well underway by the time the current EU legislative term ends in mid-2019.

**Institutional Issues.** Many of the items listed as policy proposals in the previous section imply institutional changes. They envisage an expansion of the policy authority granted to both ESMA and the ESRB, as well as the possible creation of new EU-level bodies, which may be needed to ensure adequate independence and/or specialized expertise (e.g., for the oversight of audit firms).

There have been several expressions of concern in early debates about capital markets union, particularly in the United Kingdom, about the risk that proposals for institutional change may be counterproductive to reach the aims of CMU. For example, the House of Lords report argued that “Any attempt to establish a system of pan-EU supervision would not only be contentious, but could prove an unhelpful distraction from the necessary reforms that capital markets union is seeking to bring about.”<sup>44</sup> However, this argument misleadingly paints the institutional question as black-and-white, and curiously ignores the fact that ESMA is already mandated to supervise credit rating agencies and trade repositories on a pan-EU basis. In reality, **the institutional question is of a practical, not ideological nature**. Some aims of CMU can be attained without changes in the respective institutions’ mandates, and some cannot: This is best determined on a case-by-case basis. Both the present and future situations are and will be hybrids between two extremes, in which supervision is respectively all-national (an unnecessary step backwards from the status quo) or all-European (an unrealistic and unnecessary prospect that would sit oddly with the subsidiarity principle).

A more helpful distinction is between prudential supervision, which is typically coupled to a resolution framework with possible fiscal implications, and other aspects of financial supervision such as authorizations of funds and of securities issuances, and enforcement of capital markets rules. In the current phase of EU integration, the former may be pooled within the banking union area, but its pooling across the entire European Union appears more problematic, given potential fiscal implications for which taxpayers are the final backstop. By contrast, **EU-level pooling of authority over the regulation of financial conduct would not “impinge in any way on the fiscal responsibilities of member states”** (to quote from the legislation that created ESMA and the other ESAs). The logic that led EU member states, including the United Kingdom, to support the creation of ESMA has not changed, and an adjustment of ESMA authority should not be considered intrinsically contentious if it can help to better address certain issues than the current division of labor among national authorities.

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<sup>42</sup> Hill (2015) declared his intention “to take a close look at the cumulative effect of the laws we have passed to make sure we have got the balance right between reducing risk and fostering growth.”

<sup>43</sup> Examples of successful task forces include, at the EU level, the Giovannini Group and the Larosière report, both of which were supported directly by the European Commission; and in individual member states, the Independent Commission on Banking in the United Kingdom, which was supported by an autonomous temporary secretariat composed of officials seconded from several government departments and agencies.

<sup>44</sup> House of Lords (2015), paragraph 75.

The current setup of ESMA and other EU-level agencies should not be considered intangible. On the contrary, it needs change. The funding mechanism envisaged for the ESAs has not functioned effectively,<sup>45</sup> and their governance has proven less than optimal in terms of effectiveness, independence, and quality of the decision-making process.<sup>46</sup> The **reform of the ESAs' governance and funding**, which is specifically expressed as part of the mandate given to the Commissioner for financial services by the Commission's President,<sup>47</sup> should thus be closely coordinated with the policy development of the CMU project. In the case of ESMA, the increased concentration of capital markets activity (though not of the economic benefits of strong capital markets) in a limited subset of member states raises particular questions about a framework in which each member state is currently represented at the ESMA supervisory board by its national securities regulator.

As mentioned in the previous section, the prudential oversight of CCPs is a special case. The recent reforms of derivatives markets have increased the systemic importance of CCPs, and their implementation is still far from complete. The reform agenda itself, as defined at the global level during the Pittsburgh Summit of the G-20 in September 2009, has not taken into account cross-border interdependencies in a fully adequate manner. Thus, the challenges posed by CCPs with significant international activity, such as those affiliated with the London Stock Exchange and ICE groups in the United Kingdom, raise global coordination questions as well as intra-EU ones. It appears advisable for the European Union to aim at suitable answers to such questions to be delivered at the global level, difficult as that may be, before it would envisage their permanent settlement in a consistent manner inside the European Union. In this respect, the best way to avoid politically challenging debates about supranational supervision, be it at the EU or global level, would be to devise and adopt strictly rules-based resolution mechanisms that give no discretion to authorities and distribute losses automatically across market participants in the unlikely event of a systemic failure. While such rules-based mechanisms cannot be entirely practical in the case of banks, they may be better suited to the distinguishing features of international CCPs.

**International Consistency.** The economic impact of CMU for the European Union depends in part on its international openness. As the European Commissioner for financial services recently put it, "the CMU is not about closing doors to the outside world. On the contrary, we want to see more investment from outside investors."<sup>48</sup> This implies that, as an indispensable complement to its CMU agenda, the European Union should champion international financial regulatory standards and other global initiatives as it has done in the past, not least with its landmark adoption of IFRS a decade ago. It should also have a critical look at past episodes, e.g. related to the design and implementation of the Alternative Investment Fund Managers Directive (AIFMD) or the European Market Infrastructure Regulation (EMIR), in which there have been debates about discrimination against non-EU service providers. The European Union should be exemplary in complying with global standards. It should give its full support to global bodies whose agendas and mandates are aligned with the objectives of CMU, in particular the Financial Stability Board (FSB), Committee on Payments and Market Infrastructures (CPMI), and International Organization of Securities Commissions (IOSCO). Far from being driven by idealism, such global commitments would respond to a hard-nosed vested interest of the European Union in an open and rules-based international financial order.

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<sup>45</sup> See e.g. the joint letter sent by the Chairs of the three ESAs to the ECOFIN president on November 5, 2014, available at [https://eiopa.europa.eu/Publications/Other%20Documents/ESAs\\_2014-41\\_Joint\\_ESAs\\_letter\\_to\\_EU\\_Council\\_Presidency\\_-\\_ESAs\\_Budget\\_2015\\_.pdf](https://eiopa.europa.eu/Publications/Other%20Documents/ESAs_2014-41_Joint_ESAs_letter_to_EU_Council_Presidency_-_ESAs_Budget_2015_.pdf).

<sup>46</sup> The most striking example has arguably been the ill-starred stress testing of EU banks coordinated by the European Banking Authority (EBA) in 2011, which was marred by governance shortcomings in spite of the best efforts of a competent EBA leadership and staff.

<sup>47</sup> Juncker (2014b).

<sup>48</sup> Hill (2015).

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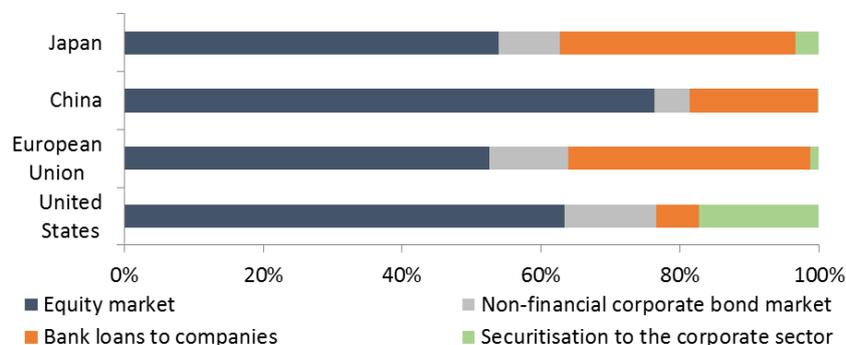
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## Appendix A

**Figure 4: Size of different financial intermediation channels as a share of total financial intermediation in the nonfinancial corporate sector**



Sources: World Bank, Association for Financial Markets in Europe (AFME), Securities Industry and Financial Markets Association (SIFMA), Asian Bonds Online, OPPLand Corporation, Board of Governors of the Federal Reserve System, European Central Bank, Bank of Japan, China Statistical Yearbook, and World Federation of Exchanges. Notes: All data converted to dollars using end-of-year exchange rates; \*Securitization is nonfinancial corporate sector in the United States (commercial mortgage-backed securities) and the European Union (commercial mortgage-backed securities as well as SME securitization) and total securitization for China and Japan.

**Table 1: United States: size of financial intermediation to the nonfinancial corporate sector**

	% of GDP				% of Total			
	Equity*	Bonds of NFCs	Loans to NFCs	Securitization	Equity*	Bonds of NFCs	Loans to NFCs	Securitization
<b>1985</b>	45	18	20	0	54	22	24	0
<b>1994</b>	69	26	16	2	61	23	14	2
<b>2004</b>	132	37	16	60	54	15	7	24
<b>2013</b>	143	44	14	59	55	17	5	23

Sources: US Bureau of Economic Analysis, Board of Governors of the Federal Reserve System, Securities Industry and Financial Markets Association (SIFMA), and World Federation of Exchanges.

**Table 2: Euro area: size of financial intermediation to the nonfinancial corporate sector**

	% of GDP				% of Total			
	Equity*	Bonds of NFCs	Loans to NFCs	Securitization	Equity*	Bonds of NFCs	Loans to NFCs	Securitization
<b>2004</b>	55	7	39	3	53	7	37	3
<b>2008</b>	40	7	51	12	36	7	46	11
<b>2013</b>	49	10	44	9	44	9	39	8

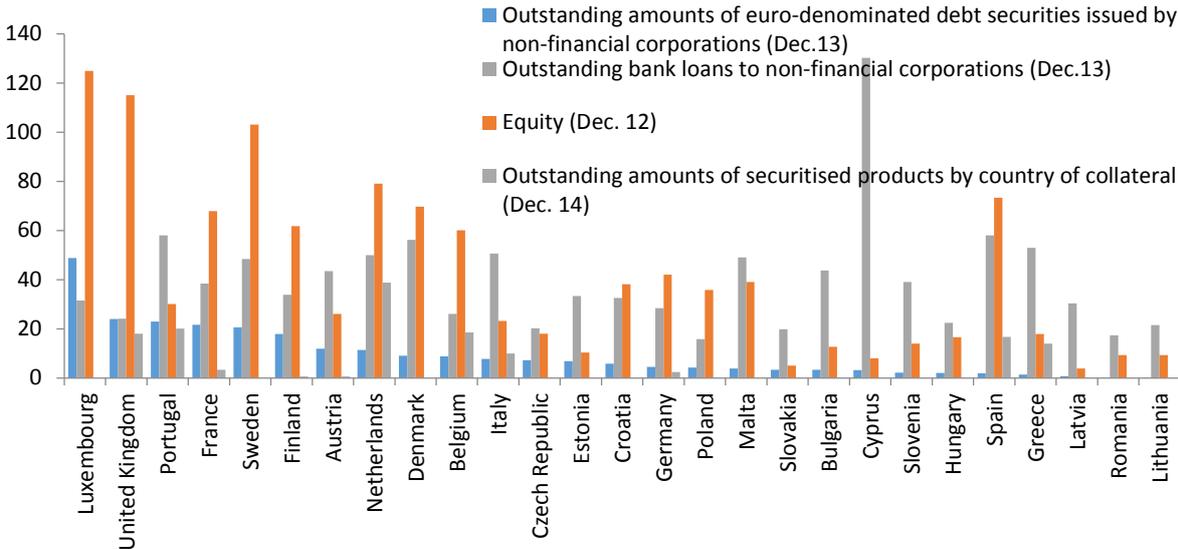
Sources: Eurostat, World Bank, Association for Financial Markets in Europe (AFME), and European Central Bank; \* Equity refers to 2012.

**Table 3: United Kingdom: size of financial intermediation to the nonfinancial corporate sector**

	% of GDP				% of Total			
	Equity*	Bonds of NFCs	Loans to NFCs	Securitization	Equity*	Bonds of NFCs	Loans to NFCs	Securitization
<b>2004</b>	123	14	41	9	65	8	22	5
<b>2008</b>	66	15	65	35	37	8	36	19
<b>2013</b>	115	21	52	19	56	10	25	9

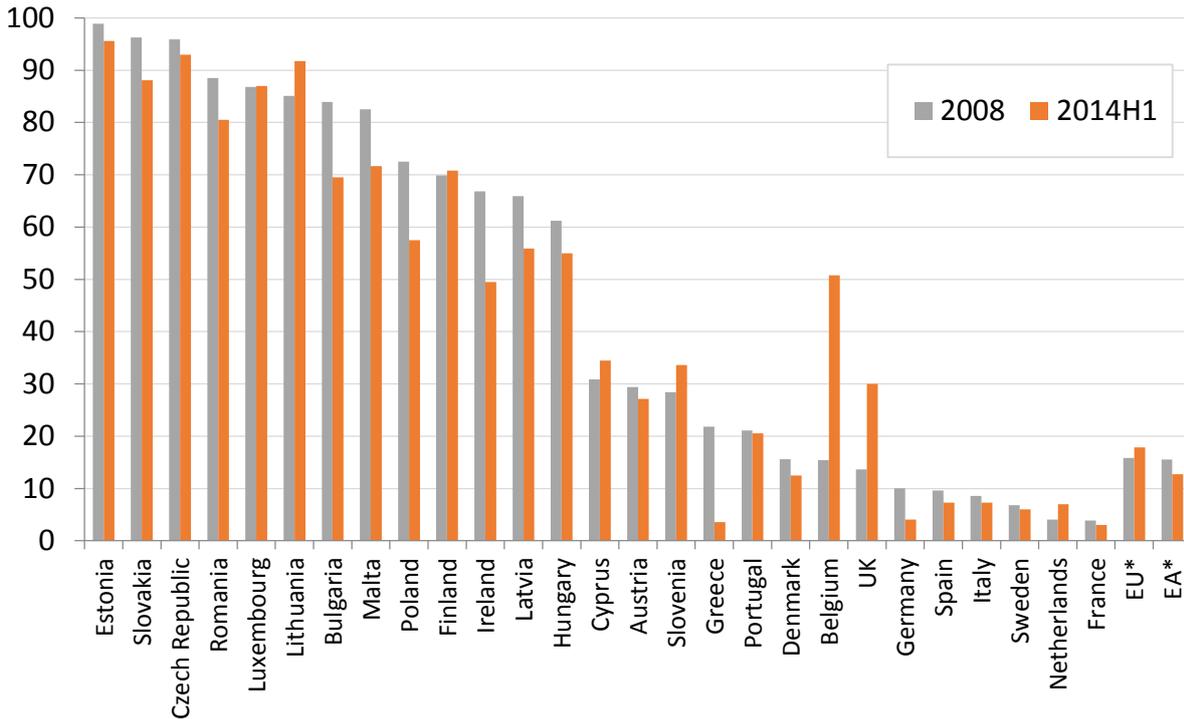
Sources: World Bank, Office for National Statistics, Bank for International Settlements, Association for Financial Markets in Europe (AFME), and European Central Bank.

**Figure 5: Breakdown of financing channels by EU country (in % of the respective country's GDP)**



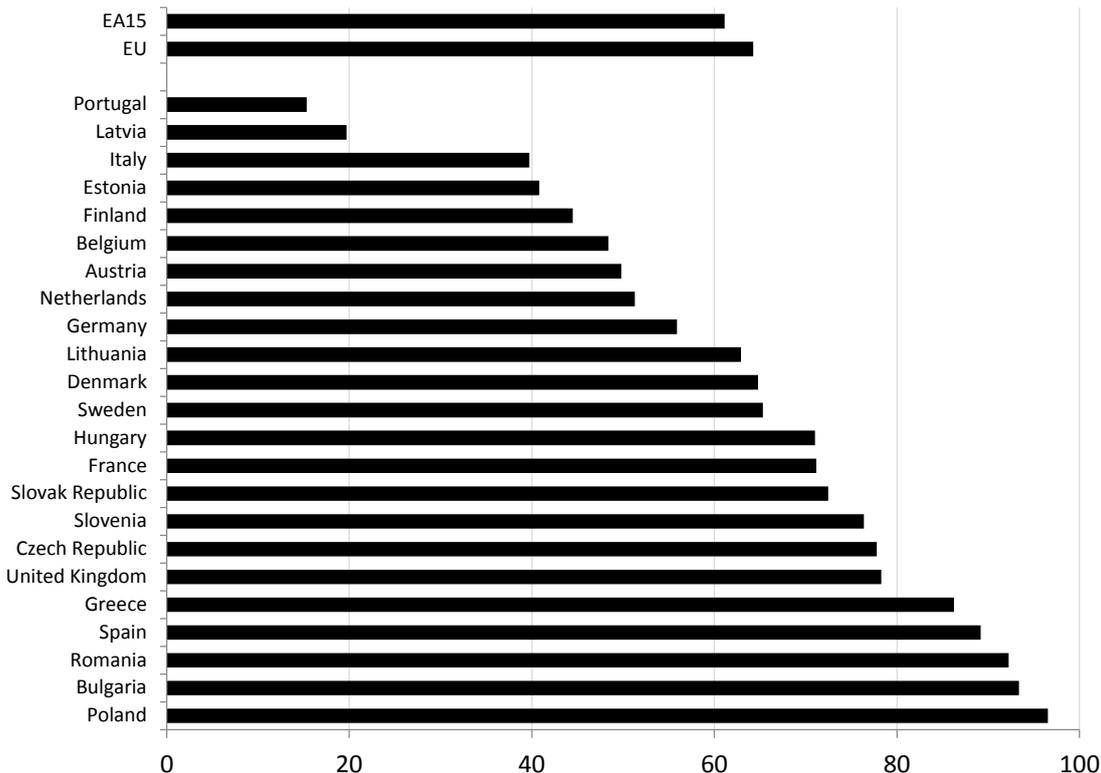
Sources: ECB, World Bank, AFME; Note: 'Equity' is defined as market capitalization of listed companies; data was transformed using the GDP of the respective period.

**Figure 6: Share of assets held by foreign banks (in %)**



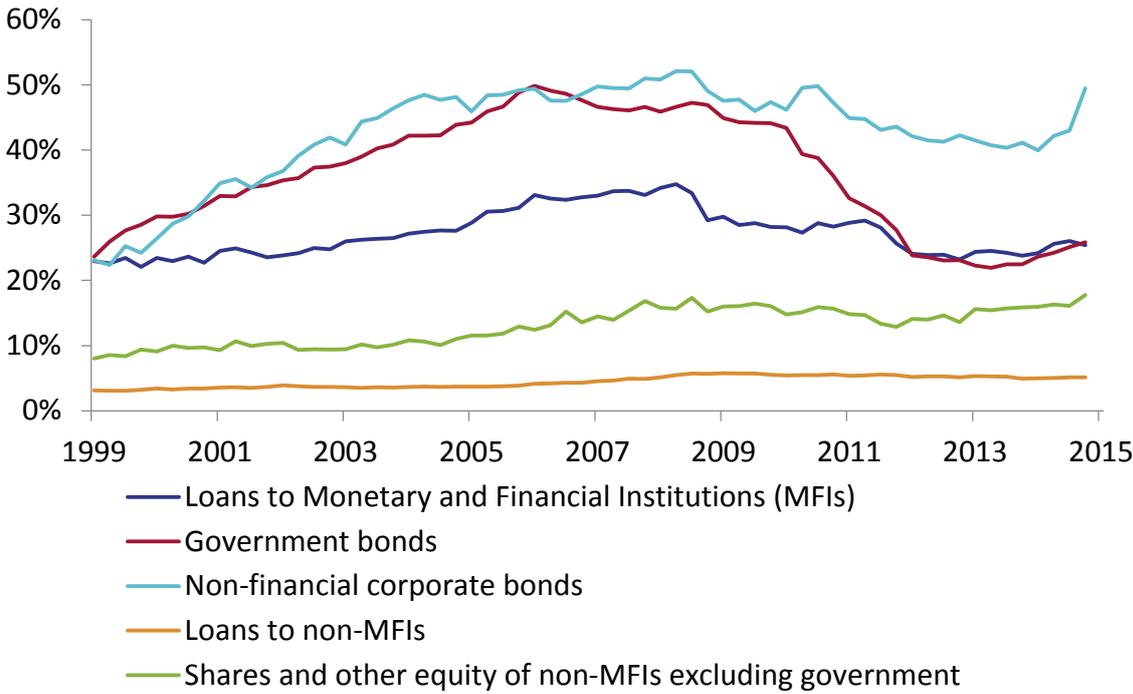
Source: European Central Bank; Note: Foreign banks are defined as subsidiaries and branches that are controlled by either an EU or a non-EU parent that is "foreign" from the reporting country's point of view.

**Figure 7: Share of domestic equity over total equity held (%), 2012**



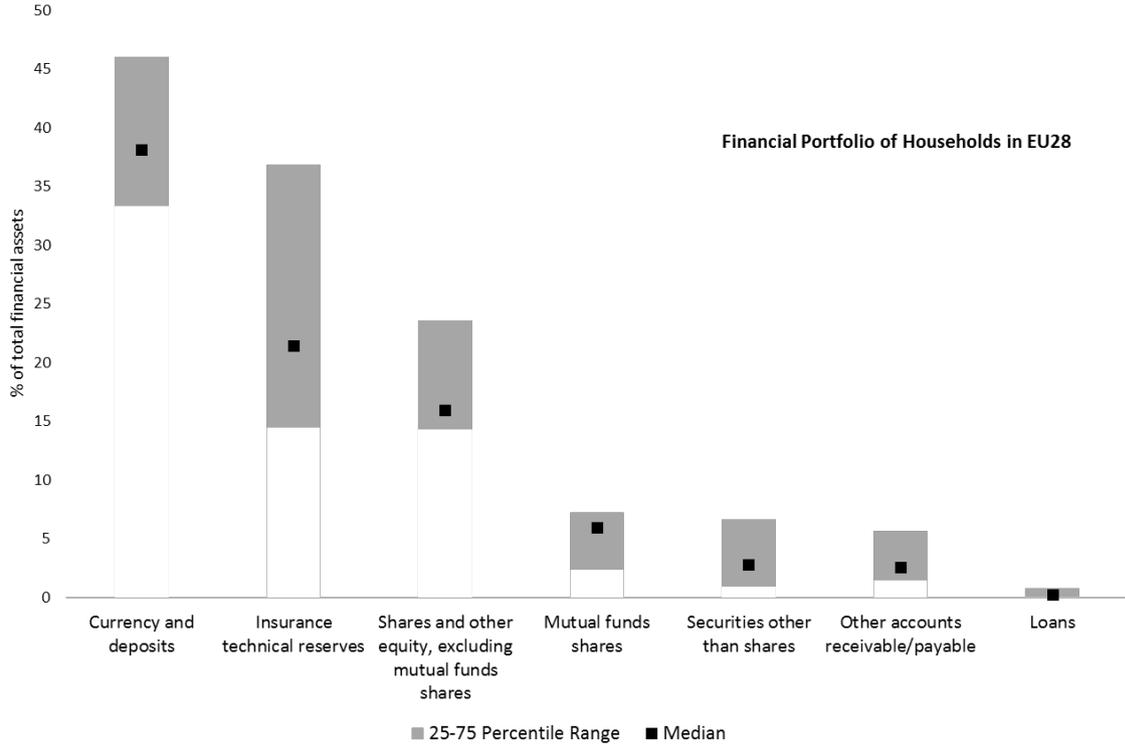
Sources: Bruegel, based on World bank data on stock market capitalization, and IMF CPIS data on cross-border holdings following Balta and Delgado (2009). Note: No data available for Croatia; Luxembourg, Ireland, Malta, and Cyprus are excluded as they attract large amounts of foreign investment.

**Figure 8: Share of cross-border holding of assets of euro area Monetary and Financial Institutions (MFIs)**



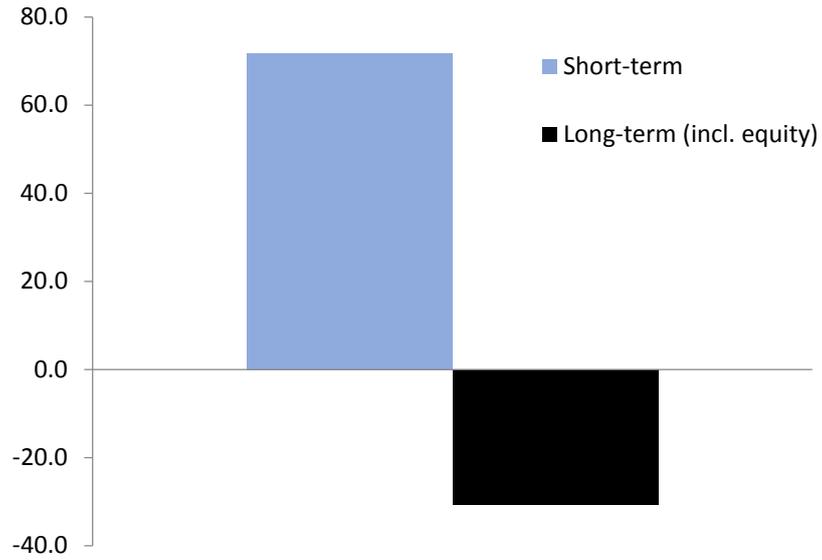
Source: Bruegel, based on ECB; Note: The lines measure the share of intra-euro area cross-border holdings in total euro area holdings.

**Figure 9: EU28 Financial balance sheet of households**



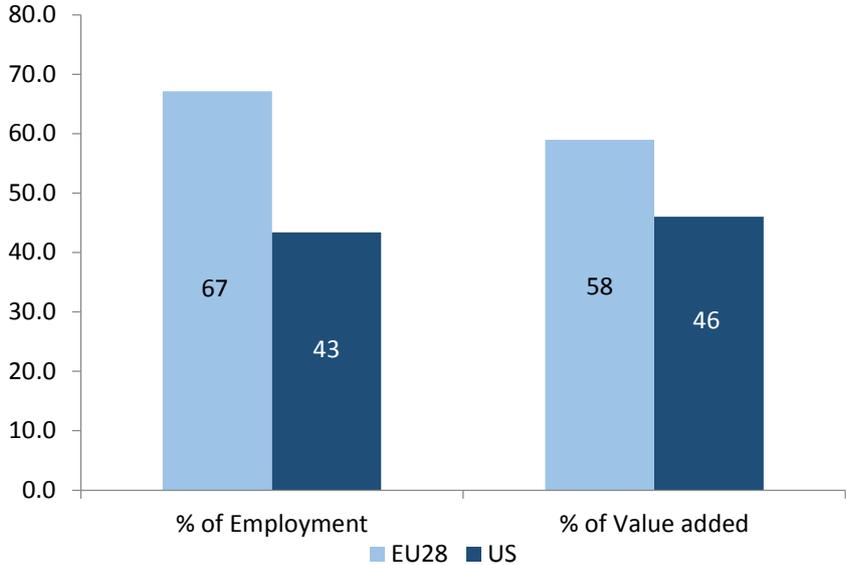
Source: Eurostat, 2012.

**Figure 10: Short-term and long-term net financial positions of the EU28 private nonfinancial sector (% of GDP, 2013)**



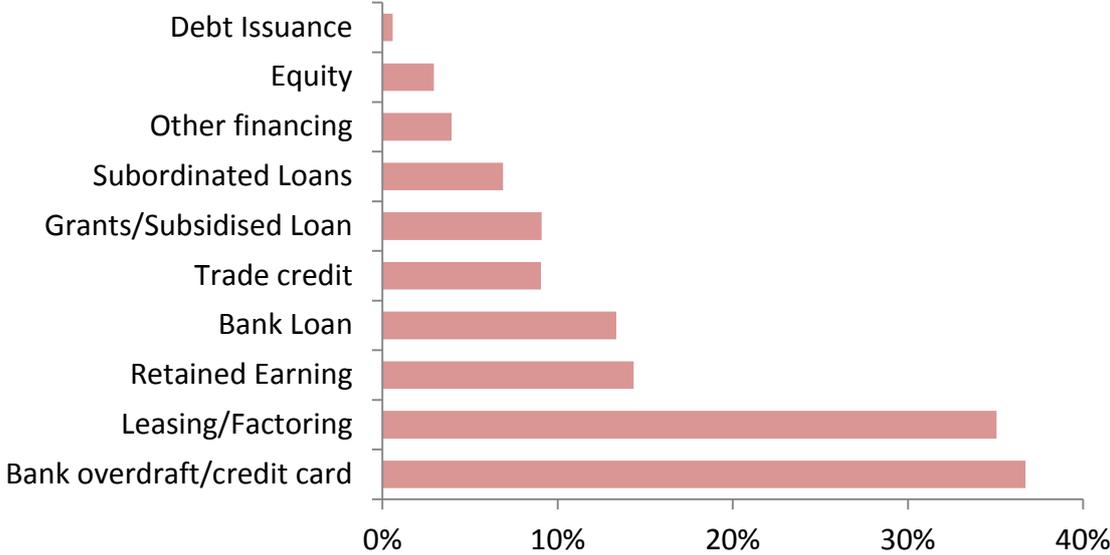
Source: Eurostat.

**Figure 11: Importance of SMEs in the EU28 and in the United States (share in total business economy)**



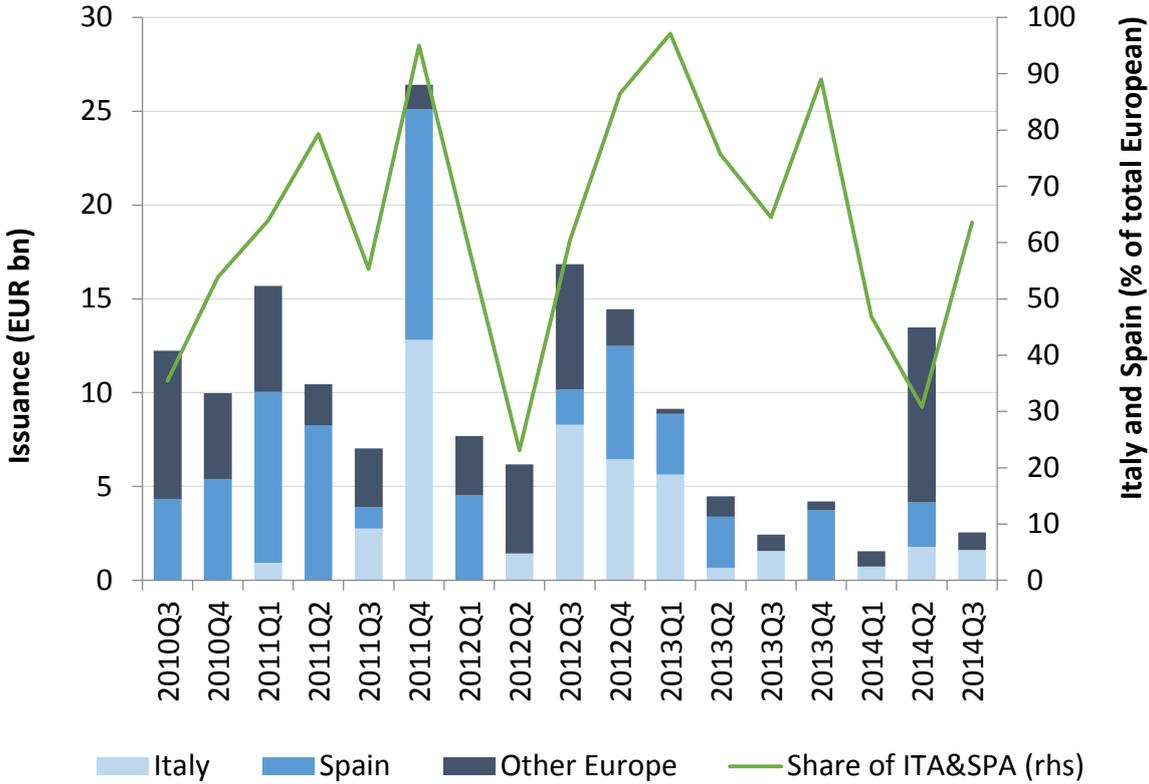
Source: Eurostat for EU28, Census Bureau and Small Business Administration (SBA) for the United States.  
 Note: SMEs are defined as enterprises of the business economy (excluding financial services) having fewer than 250 employees; all data refer to 2012, except the percentage of value-added for the United States, which is defined as the percentage of private sector at the last reported date in 2010.

**Figure 12: Sources of SME financing in the past 6 months (% of EU28 SMEs)**



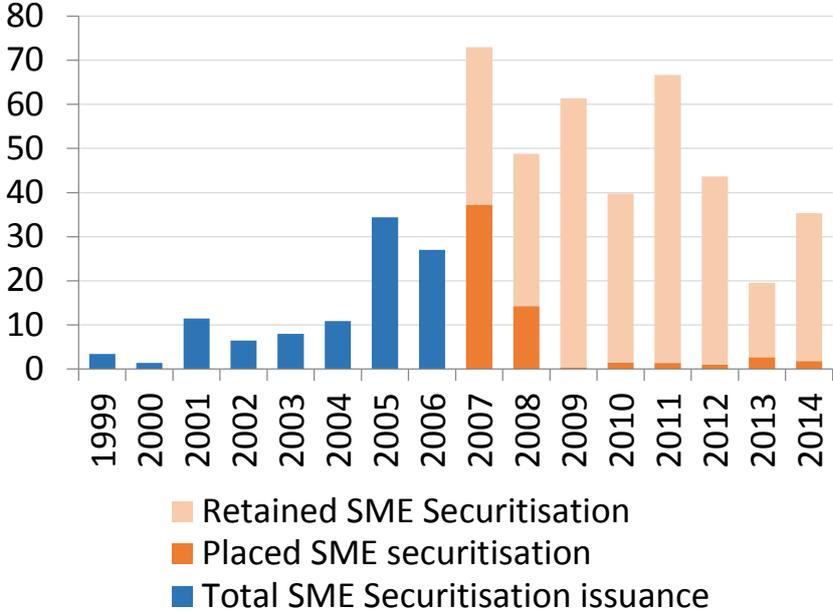
Source: European Commission, SAFE 2014.

Figure 13: SME securitization



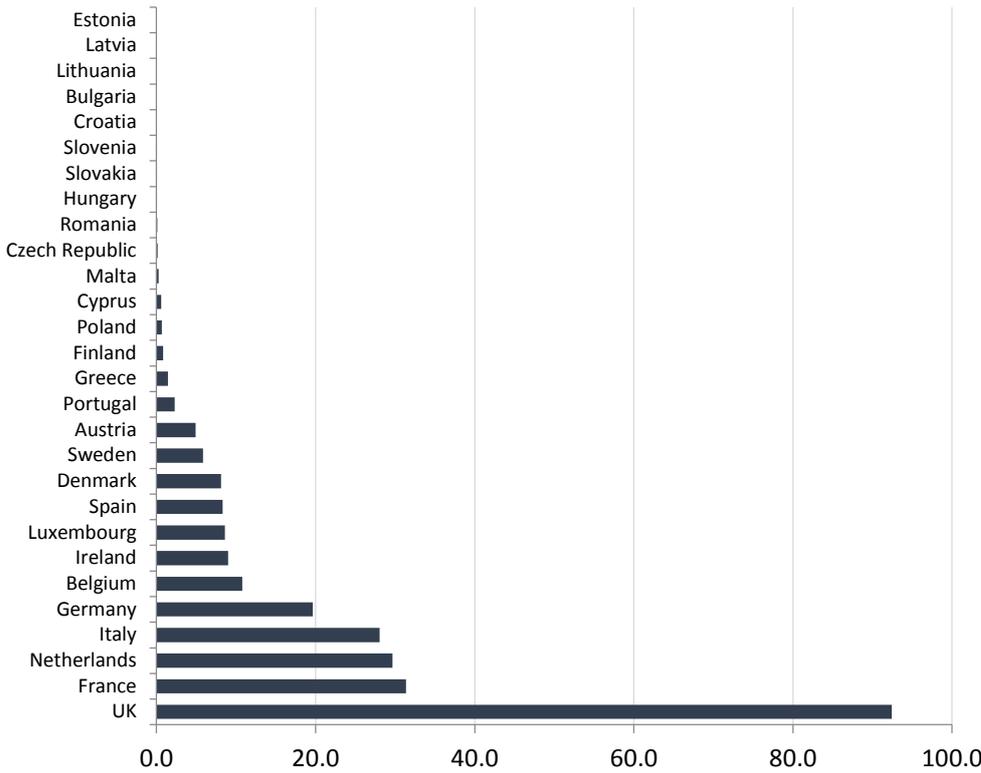
Source: AFME.

Figure 14: European SME Securitization Issuance by retention (in billions of euros)



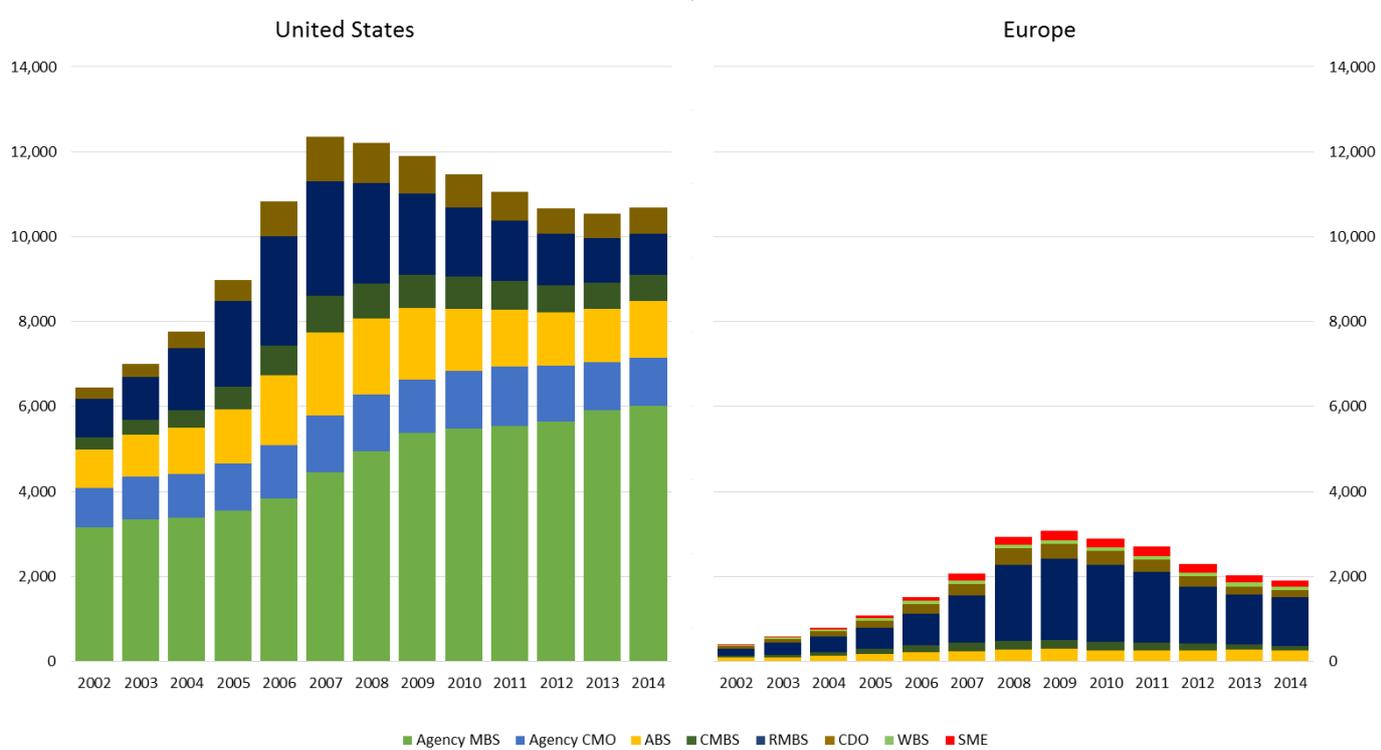
Source: AFME; Note: since 2007, the total issuance can be split between 'retained' and 'placed', where 'placed' refers to securitizations placed with investors on the primary market and 'retained' refers to securitizations retained by banks to create liquidity buffers and to access ECB liquidity.

**Figure 15: Wholesale financial activities, gross valued added (in billions of euros)**



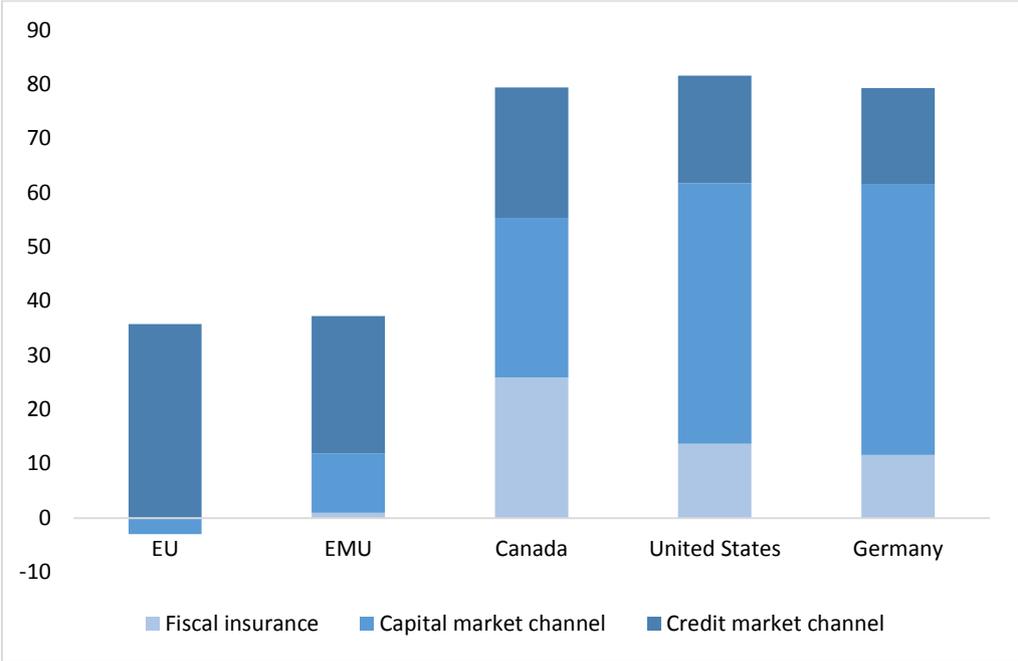
Source: Eurostat, 2013.

**Figure 16: US and European securitization outstanding (billions of US dollars)**



Sources: Securities Industry and Financial Markets Association (SIFMA).

**Figure 17: Risk sharing (percent of shock smoothed by the different channels)**



Sources: IMF (2013), Figure 2.