European supervision fit for capital markets union

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Capital markets union (CMU) is a European Union (EU) goal that will lead to a single market for financial services and free flow of capital. CMU offers a harmonised pan-European capital market where citizens can invest in markets of other countries as if they were investing on their own local bourse. CMU is good for economic growth, good for financial stability, and good for the international role of the euro. But to assure its success, CMU also requires well-organised regulation, to protect investors and foster prosperity.

Last summer, a High Level Forum reported on the progress needed to make CMU work. One of this blog's authors was a Forum participant. The authors of this blog followed up by publishing a blog post detailing the five inescapable "S" features CMU needs. In November, the European Commission, which convened the Forum, published a CMU action plan that also factored in the evolving Covid-19 pandemic as well as the United Kingdom's (UK) EU exit.

In this blog, we explain why, to achieve a successful CMU, one of those "S" features, supervision, must comprise three pillars of European supervision. These pillars are: leading in areas of financial innovation, enforcement of supervisory convergence, and direct supervision of institutions with a cross-border footprint. We acknowledge that some aspects of supervision are best handled by national regulators within European countries, while others require a pan-European approach in step with CMU. Harmonised and integrated financial supervision in Europe, reflecting the principles of subsidiarity and proportionality in EU Treaties, is crucial for building safer capital markets and ensuring a level playing field for all market participants.

The convergence of supervision practices has become even more pressing post-Brexit. In the past, the concentration of wholesale financial services - such as derivatives clearing -

meant that the UK supervisor acted de facto as a central agent for the EU. This will no longer be the case, either because of regulatory divergence over time or decentralised financial services. Moreover, the EU may face tougher competition from the highly-developed UK capital market hub, as well as from financial centres in Asia, the Middle East, and the United States (US). This means European financial services need a strong CMU. And *boosting European supervision is one of the game changers*.

First steps taken - more progress needed

The regulations passed in the aftermath of the 2008 financial crisis dealt mainly with investor protection and market transparency (MIFID 2/R), trading of derivatives (EMIR), securities depositories (CSDR), and securities financing (SFTR). They defined a more complete single rulebook for EU capital markets. In 2011, the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pension Authority (EIOPA) were created.

However, the implementation of this rulebook and the set-up of the supervisory authorities responsible for it still differ from one EU country to another. Enforcement powers are often splintered among several national regulators.

The challenge for the EU is to define and build up an efficient supervisory model that harmonises markets and upholds transparency and investor protection. At present, divergent supervisory practices across the EU hamper cross-border investments.

The US has shown that the implementation of sound, centralised supervision at the federal level is the best guarantee for a deep and integrated market. The two main agencies, the Securities Exchange Commission and the Commodity Futures Trading Commission, have clear missions to enforce US laws on securities and markets, propose new rules, and supervise financial institutions operating in the US capital markets. They provide central supervision for the US market as a whole.

We believe European capital markets need increased powers and responsibilities for ESMA and EIOPA, with a three-pillar structure. First, the EU should ensure ESMA and EIOPA take a leading role in defining regulations and supervision practices applying to new financial and market activities. Second, the EU should strengthen the enforcement powers of ESMA and EIOPA to guarantee the convergence of market practices. Third, the EU could draw inspiration from banking union to implement direct supervision by ESMA and EIOPA of the most international market participants, such as cross-border banks.