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This volume, titled "**Regulatory and Compliance Insights**", focuses on the significant progress and ongoing challenges in the field of financial regulation and compliance. The articles are organized to cover key themes such as, capital markets, independence of financial supervision, digital transformation, and capacity building, reflecting the comprehensive approach needed to address the dynamic nature of financial markets.



2.1
Academic Article

Capital Markets Union: What Will It Take to Be a Success

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Author's Bio



Pierre-Henri Conac is Professor of Financial Markets Law at the University of Luxembourg. He is also Max Planck Fellow at the MPI Hamburg. He is the author of 'The regulation of securities markets by the French Commission des opérations de bourse (COB) and the US Securities and Exchange Commission (SEC)'. He has written numerous articles on corporate and securities law and co-edited several books. He has been involved in policy making in financial law, banking law and company law at EU and national level. He participates regularly at conferences and seminars on such topics in Europe and internationally. He is also the chair of the European Model Company Act (EMCA) Group. He is managing editor of the *Revue des Sociétés* (Dalloz) and co-chief managing editor of the *European Company and Financial Law Review* (De Gruyter).

Abstract

The Capital Markets Union (CMU) was launched in July 2014 by the European Commission as a project to harmonise the rules applicable to the financial sector. The CMU is a continuation of the De Larosière report of February 2009, which advocated “central regulation - local supervision” for the financial industry (banking, securities, insurance). This approach relied on the adoption of a Single Rule Book (SRB) to ensure that the same rules are applicable throughout the single market and to the creation of a European Securities and Markets Authority (ESMA). Critics have recently expressed the view that the SRB has not led to a sufficient flow of cross-border transactions. It is true that the current situation does not always ensure a completely harmonised SRB and supervisory convergence. However, centralisation of supervision, as advocated, will not, per se, make the CMU a success. It might not even be effective. Rather, incremental technical changes can achieve a much stronger single rulebook and supervisory level-playing field. Therefore, the goal of the new legislative action on the CMU should be to adopt targeted technical changes to increase cross-border activities.

Capital Markets Union – What will it take to be a success?

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Introduction

The Capital Markets Union (CMU) was launched in July 2014 by Jean-Claude Juncker, President of the European Commission, as a project to harmonise the rules applicable to the financial sector. The CMU was a continuation of the harmonisation effort sought by the European legislator after the great financial crisis of 2008. It was also designed to expand the size of the European financial market by increasing cross-border activity. Finally, the CMU was intended to encourage the United Kingdom (UK) to remain in the European Union (EU), ahead of the Brexit referendum. Specifically, the CMU was tailor-made to make it easier for the City of London to export its services to the rest of the EU.¹ Unfortunately, London was not the only city in the United Kingdom to vote. So, after Brexit, the CMU became a stand-alone EU project.

¹ See Nicolas Véron, speaking about an 'An anti-Brexit Initiative' in Nicolas Véron, *Capital Markets Union: Ten Years Later, In-Depth Analysis, Requested by the ECON committee, European Parliament, Economic Governance and EMU scrutiny Unit (EGOV) Directorate-General for Internal Policies* (PE 747.839, March 2024) 8–9.

The CMU is a continuation of the De Larosière report of February 2009, which advocated “central regulation - local supervision” for the financial industry (banking, securities, insurance). This approach relied on the adoption of a Single Rule Book (SRB) to ensure that the same rules are applicable throughout the single market. The De Larosière report also called for the creation of a European Securities and Markets Authority (ESMA) which was set up in 2011. ESMA is an agency of the EU and essentially represents the authorities of the Member States, the National Competent Authorities (NCAs), because of the composition of its governing body. The Board of Supervisors includes, as voting members, the 27 NCAs and the Chair of ESMA. ESMA has been tasked with helping the European Commission to develop so-called “level 2” rules and to ensure a uniform interpretation and application of the SRB. This is achieved through “supervisory convergence” and is done by ESMA mostly by means of so-called “level 3” rules such as Orientations or Guidelines, as well as Statements, Positions etc.²

The current CMU (2014-2024) covers various topics, and its success is not the same across all areas. On the positive side, the SRB was completed in just a few years and is a huge regulatory success. However, harmonisation is sometimes partial as the content of the EU legislation does not cover all the aspects, or answers all possible questions, leaving room for interpretation. The passport for listed issuers and financial intermediaries is also effective in many fields. However, some financial actors complain that providing cross-border financial services is not always easy due to legal differences. On the negative side, some NCAs are accused of unfair competition by passporting financial products using a regulatory light touch approach. This accusation is targeted at a very limited number of NCAs so it should not be overstated.³ Also, the level of enforcement and sanctions varies among jurisdictions although this could be explained by the different market structures and legal traditions.

Critics have recently expressed the view that the SRB has not led to a sufficient flow of cross-border transactions.⁴ The single financial market is too small compared with the United States. Companies are also still too reliant on bank and debt financing compared to equity financing. This affects the competitiveness of the European economy. Therefore, the European Commission and the Council are seeking to relaunch the CMU.⁵

The current situation does not always ensure a completely harmonised single rulebook and supervisory convergence (I). However, centralisation of supervision, as advocated, will not, per se, make the CMU a success (II). It might not even be effective. Rather, incremental technical changes can already achieve a much stronger single rulebook and supervisory level-playing field (III). Therefore, the goal of the new legislative action on the CMU should be to adopt targeted technical changes to increase cross-border activities.

2 Niamh Moloney, *The Age of ESMA: Governing EU Financial Markets* (reprint edition, Hart 2021); Pierre-Henri Conac and Niamh Moloney, ‘EU Financial Market Governance and the Covid-19 Crisis: ESMA’s Nimble, Responsive, and Speedy Response in Coordinating National Authorities through Soft-Law Instruments’, (2020) 17 *ECFR* 363, 363–385.

3 ESMA, *Recommendations to the Cyprus Securities and Exchange Commission on the supervision of cross-border activities of investment firms* (ESMA42-110-3354, 10 March 2022).

4 Fabrice Demarigny, ‘L’autonomie stratégique passe par l’Union des marchés de capitaux’ (*Le Grand Continent*, 11 January 2024) <<https://legrandcontinent.eu/fr/2024/01/11/lautonomie-strategie-par-lunion-des-marches-de-capitaux/>>

5 Statement of the Eurogroup in inclusive format on the future of Capital Markets Union (11 March 2024) <https://www.consilium.europa.eu/en/press/press-releases/2024/03/11/statement-of-the-eurogroup-in-inclusive-format-on-the-future-of-capitalmarkets-union/>

01

The current situation does not always ensure a complete single rulebook and supervisory convergence

One of ESMA's missions is to achieve supervisory convergence. From the outset, this objective has been part of the tasks assigned to it by its founding Regulation 1095/2010 of 24 November 2010 ("ESMA Regulation").⁶ It would contribute to the realization of the CMU. However, ESMA can hardly sanction the deviations of national supervisors, legitimate or less so (A). In addition, there is not a true SRB in all fields covered by EU legislation meaning that differences necessarily appear among Member States (B).

A. The limitations of ESMA tools

Firstly, national competent authorities do not wish, in principle, to disregard the Single Rule Book. They are responsible for applying European and national legislation. It is therefore not surprising that it is very difficult to find outright deviations or violations.

Secondly, ESMA has to identify differences. This is done mostly through peer reviews which are intensive and time consuming in terms of human resources. They provide mixed results as differences can stem from legitimate legal and supervisory traditions or simply a lack of adequate supervisory resources that an NCA cannot simply increase at will.

Thirdly, many cases result from the sometimes vague and unclear nature of European legislation which is the product of difficult compromises. As a result, good faith differences of interpretation among NCAs, again often stemming from different legal traditions or resulting from their expertise, are to be expected and can be perfectly legitimate. Therefore, most differences of interpretation are done in good faith.

If the differences of interpretation and in supervisory practice are less benign, it is difficult to overcome those difficulties if the NCA opposes. It is much easier to oppose in terms of supervisory practices rather than in case of interpretation of EU legislation.

For instance, ESMA is essentially powerless against an NCA which would provide too easily a passport to investment firms or financial products compared to other NCAs. It can issue recommendations under article 16 of the ESMA regulation but not much more.⁷ Therefore, there is always a risk of unfair competition among national supervisors.

6 Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC [2010] OJ L331/84.

7 Cyprus SEC. ESMA (n 3).

ESMA can also use the procedure for breach of Union law.⁸ However, if a breach is detected, it might be difficult to impose a sanction.⁹ First, it is very rare for an authority not to comply with ESMA's interpretation during the investigation phase. The procedure is designed to avoid the need for a vote. No authority wants to be subjected to an official and public procedure for violating EU law. This explains why there are so few procedures because alignment occurs naturally. The effectiveness of the procedure is real and is mainly due to its dissuasive nature.¹⁰

In the event of a breach, it is still difficult, but not impossible, to obtain a conviction against the defaulting NCA. This is because the decision is taken by the Board of supervisors of ESMA. However, national authorities have a natural tendency not to want to punish each other, especially as they are called upon to cooperate. The absence of any condemnation of Danske Bank by the European Banking Authority (EBA) in 2019 is an illustration of this bias. ESMA's reform, which facilitates decision-making by the Board of Supervisors by reversing the majority, will not necessarily bring about a paradigm shift. This would probably require changing the composition of the Board by adding external members.

B. The incomplete single rulebook

The fact that the SRB and supervisory convergence is not achieved is also due to the limits of EU legislation itself which, although very precise, cannot address all questions.

For instance, there are differences among NCAs when it comes to imposing sanctions (enforcement). These differences reflect different national sensitivities that are difficult to harmonise since they are quasi-judicial decisions of national authorities.

Also, the single rulebook is not heavily balanced in all fields even when there is an EU legislation. For instance, article 17 of the Market Abuse Regulation (MAR) of 2014 on the duty to disclose inside information does not cover the question of whether an issuer can be liable if it did not know the information it is supposed to disclose. Should the issuer be supposed to know the information ("knowledge governance")? Also, Article 17 of MAR does not cover the question of when the issuer is supposed to know the inside information: senior management, intermediate management.... This case is being currently discussed in Germany in the context of the Dieselpgate scandal of 2015 involving Volkswagen.¹¹ Therefore, EU legislation leaves room for interpretation by national Courts, unless a preliminary ruling is filed with the Court of Justice of the European Union (CJEU).¹²

8 Guidelines and Recommendations, Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC [2010] OJ L331/84, art 16.

9 ESMA Regulation, Breach of Union law, art 17.

10 Pierre-Henri Conac, 'The Breach of Union law procedure and the European Supervisory Agencies (ESAs): an effective tool suffering from an expectation gap' in Gavin Barrett, Jean-Philippe Rageade, Diana Wallis and Heinz Weil (eds), *The Future of Legal Europe: Will We Trust in it? Liber Amicorum in Honour of Wolfgang Heusel* (Springer, 2021) 97, 97–116.

11 Jens Koch, 'Die Ad-hoc-Publizität: Veröffentlichungs- oder Wissensorganisationspflicht?' (2019) 64 AG 2019 273, 273–286; Jens Koch, 'Ad-Hoc-Pflicht: Knowledge statt Knowledge Governance, (2024) 69 AG 97, 97–111.

12 Mario Hössl-Neumann and Andreas Baumgartner, 'Dealing with Corporate Scandal under European Market Abuse Law: The Case of VW' 2018 Stanford – Vienna Transatlantic Technology Law Forum, European Union Law Working Papers No. 37/2018 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3281009>

Another recent example is the interpretation of article 30 1. (b) of MAR on administrative sanctions and other administrative measures which provides for sanctions for “failure to cooperate or to comply with an investigation, with an inspection or with a request as referred to in Article 23(2)”. The French Cour de cassation held that this offence of obstruction of an administrative investigation is objective in nature, and that there is no need to show that the person from whom the information was requested deliberately sought to obstruct an investigation.¹³ The Court also held that the obstruction exists regardless of whether the hindrance arises from a request for information or documents submitted to a foreign authority in the context of international cooperation. The question of whether the offence of obstruction of an administrative investigation implies to establish bad faith has been decided in France only. Therefore, courts in other Member States could still decide otherwise.

These and other shortcomings led some Member States to argue for a centralised supervision by ESMA as a necessary condition for the success of the CMU.¹⁴

02

Centralisation of supervision will not intrinsically make the CMU a success

An attempt to centralise supervision, limited to certain prospectuses, was already made by the European Commission in 2017, with the support of France. This attempt failed despite the departure of the United Kingdom due to a coalition of liberal states. France has again called for full centralisation (A), but this is being contested and would not bring, per se, an increase in the size of the single financial market (B).

A. Calls for a centralization of supervision

Christine Lagarde, President of the European Central Bank (ECB), reopened the debate in 2023 by calling for centralisation of financial supervision.¹⁵ Quoting the American poet Ralph Waldo Emerson and calling for a “Kantian moment”, she argues that centralisation would be necessary to finance the green transition on the model of rail financing in the United States in the 19th century. The argument is surprising given that financial supervision was centralised in the United States within the Securities and Exchange Commission (SEC) in 1934, after the construction of the railway network.

¹³ Elliott Advisors (XPO Logistic Inc.; crossing of threshold through Swaps (cash settled derivatives) [2024] Cour de cassation, Chambre commerciale financière et économique, 4 avril 2024, Pourvoi n° 22-19.127.

¹⁴ Robert Ophèle, ‘Vers une supervision unique pour les marchés financiers en Europe?’, (2017) 42 JCP E 6.

¹⁵ Christine Lagarde, ‘A Kantian Shift for the Capital Markets Union’ (European Banking Congress, Frankfurt am Main, 17 November 2023) < <https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp231117~88389f194b.en.html> >.

Nicolas Véron also calls for centralised supervision although he notes that this should be only one element. The best way to revitalise the CMU would be to focus on integrating supervision through fundamental reform and strengthening the powers of the ESMA. He argues that if it is not possible to achieve more integrated supervision, it may be time to abandon the CMU project altogether.¹⁶

Other arguments have been put forward. For example, the passport for shares and investment funds would not work. Therefore, the single financial market is smaller than it should be otherwise. Retail investors tend to purchase shares of their national companies on their national market and international shares through UCITS while wholesale investors easily purchase shares and bond cross-border. The size of the market is not hampered by the fact that issuance is not passported but rather affected by investment preferences of retail and wholesale investors. Unsurprisingly, this argument has not been taken up in any official texts. Inversely, the argument that the passport works well has also been used to justify centralising supervision. Some also predict that the size of the single market would double if supervision were centralised. This would make it easier for companies to raise capital. This is, at best, a pascalian gamble. In addition, the centralization of supervision is rejected by many Member States.

B. Centralisation of supervision rejected in Europe

Centralising supervision in Europe faces political opposition and is not the best way to achieve the CMU.

Some Member States, like Italy, Belgium, and the Netherlands, are supporting France. Germany's position is crucial but ambiguous and historically hostile to centralised supervision. In addition, there is strong political opposition from Member States with major financial centres, such as Luxembourg, and also smaller Member States.¹⁷ Among the arguments is a fear that France will take control of ESMA to the detriment of other financial centres.¹⁸

This does not mean that some centralization of critical infrastructures such as European Central Clearing Counterparties (CCPs) would not make sense because they are already centralized. However, this should be decided on a case-by-case basis. Centralising supervision would not make the CMU more effective. As the chairman of the Spanish stock exchange authority noted at the last Eurofi conference in February 2024, “Centralization of supervision towards ESMA, indeed, can have its benefits in some areas, but is largely irrelevant when attracting a multitude of companies to capital markets. Does anybody believe that SMEs would rush towards equity markets because their prospectuses or their financial reports would be approved or enforced by ESMA instead of their local supervisor?”¹⁹ The chairman of the Spanish stock exchange authority rightly believes that “The banking ‘union’ is not the right reference for the Capital Markets Union”. This can be seen in banking where, for example, centralised supervision has not led to greater integration and the emergence of European champions. Here too, the national rules that the ECB must apply sometimes remain different and their application subject to national traditions that are difficult to harmonise.

¹⁶ Véron (n 1).

¹⁷ Paola Tamma, Henry Foy and Alice Hancock, ‘Majority of EU States Object to Capital Markets Reform Push’ *Financial Times* (April 18, 2024).

¹⁸ Diego Velazquez, ‘Luxembourg Resisting EU Push for Financial Markets Union’ *Luxembourg Times* (18 April 2024).

¹⁹ Rodrigo Buenaventura, ‘Increasing Equity Financing’ *The EUROFI Magazine* (February 2024) 224.

In fact, the financial markets are still national for retail investors, which implies national supervision, unlike in the United States where the financial markets were already essentially centralised in New York when the SEC was created.

Also, partial centralisation already exists in some fields. For example, Luxemburg and Ireland handle a large part of the cross-border marketing of investment funds. Sweden has developed a highly internationalised stock market without any centralised European supervision. The bond market does not need centralised supervision either, as it is easily accessible to professional investors in Europe and around the world.

Finally, centralising supervision would have the disadvantage of reducing competition between national supervisors. For instance, the possibility of passport prospectuses allows more efficient supervision by specialists and allows issuers to engage the most qualified entities. Therefore, slow and bureaucratic supervisors can be sidestepped. So, even when there is a level playing field, competition brings benefits in terms of dynamics and avoids the risk of national authorities becoming too bureaucratic. It thus contributes to the competitiveness and dynamism of the single market. Europe is a permanent laboratory of ideas and competition is a driver of positive change. For instance, Sweden developed an ecosystem and has developed financial markets which are large and cross-border in nature. Sweden also inspired the reform of the prospectus regime by the Listing Act. Centralisation of supervision at European level would mean the loss of this competitive spur with no way of getting back.

A more effective approach would be to proceed through incremental changes that would bring strong benefits in terms of harmonisation and supervisory convergence.

03

Incremental changes to achieve a stronger single rulebook and a supervisory level playing field

The CMU can be better achieved through increased harmonisation of European legislation and by strengthening the effectiveness of supervisory convergence.

The adjustment of rules through the single rulebook can be strengthened by increasing maximum harmonisation as much as possible. This has already been done in the field of prospectus and has yielded considerable results in terms of passporting.²⁰ Another improvement would also be to provide as much precision as possible in the EU legislation. This would go a long way to ensure adjustment of rules cross-border. In addition to strengthening the intensity of the harmonisation, other reforms could increase the effectiveness of supervisory convergence.

The effectiveness supervisory convergence could be strengthened through targeted measures. To limit the risks of abuse by NCAs, the EU legislator could provide ESMA with the right to remove the passport in case of abuse or give it to the host NCA. A joint 2021 position paper by the French *Autorité des Marchés Financiers* (AMF) and the Dutch *Autoriteit Financiële Markten* (AFM) have put forward interesting propositions.²¹ For instance, they suggest strengthening the host NCA abilities under article 86 of MiFID 2. A reform would limit the timeframe within which home NCAs must act once solicited by the host NCA and allowing host NCAs to use temporary measures against firms which can be lifted once home NCAs take appropriate action. Also, currently, the presence of a branch office in a host Member State is key in determining the division of home/host responsibilities with respect to conduct supervision. Increased digitalisation makes this determinant outdated. Therefore, there is a need for a more effective division between home and host NCAs responsibilities with respect to conduct supervision, as well as more powers for host NCAs on matters of conduct.

Another improvement would be for the CJEU to repeal the “Meroni” doctrine which severely limits the powers of ESMA to adapt the single rule book fast enough both at Level 2 and at Level 3. The Meroni decision of the European Court of Justice limits the delegation of powers granted to agencies or authorities like ESMA, in so much as they cannot enjoy discretionary powers.²² The validity of the Meroni doctrine was reaffirmed in 2014 by the European Court of Justice in the case of ESMA.²³ Although the Court ruled in favour of ESMA, the Meroni doctrine stands in the way of providing ESMA with full discretion. Therefore, unsurprisingly, ESMA has recently proposed some reforms, including revisiting the Meroni doctrine.²⁴

20 ESMA, *ESMA Market Report: EU Prospectuses 2023* (ESMA50-524821-3029, 21 December 2023).

21 AMF–AFM, Position paper: Strengthening Conduct Supervision in Cross-Border Retail Financial Services to Create a More Efficient EU Capital Market (22 December 2021) <<https://www.amf-france.org/sites/institutionnel/files/private/2021-12/position-paper-cross-border-afm-amf.pdf>>

22 Case 9/56 Meroni v High Authority [1957 and 1958] ECR 133.

23 Elizabeth Howell, ‘The European Court of Justice: Selling Us Short?’ (2014) 11 ECFR 454, 454–477.

24 ESMA, Building More Effective and Attractive Capital Markets in the EU, Position Paper 2024 <https://www.esma.europa.eu/sites/default/files/2024-05/ESMA24-450544452-2130_Position_paper_Building_more_effective_and_attractive_capital_markets_in_the_EU.pdf>.

04**Conclusion**

The debate on the CMU has been much focused on the centralisation of supervision of financial markets which would be entrusted to ESMA. In its April 2024 report on the Single Market, Enrico Letta advocates a centralisation of supervision of the most integrated markets or significant market players to ESMA, particularly when supervision proves more effective at a supranational level, such as with equity markets or certain large systemic entities.²⁵ Another idea of the report is that the Commission would assess market integration for each Directive or Regulation moving forward. In such case, centralisation of supervision would be justified. Those proposals closely reflect some ideas advanced by Fabrice Demarigny.²⁶ However, such moves would not achieve supervisory convergence and result in an increase in size of the market in and of itself.

The difficulties with the CMU and the size of the single financial market are not just linked to realizing the single rulebook and supervisory convergence. They are of a more systemic nature and need manifold measures in order to improve the situation.

Some issues hampering the development of financial markets, and especially equity financing of European based companies in Europe, are being slowly fixed.

A major obstacle to listing in the last two decades has been the competition of private equity for financing the growth of companies. The policies of central banks in Europe and in the United States to have zero interest rate policy (ZIRP) or even negative interest rates policy (NIRP) has meant easy access to cheap and unlimited financing for private equity firms which can overpay compared to a listing on a stock exchange. However, this obstacle is being removed because of inflation which has led to a quick and strong increase in short term and long-term interest rates.

There are also legal and regulatory obstacles. For instance, the tax treatment of retail investors funding cross-border and subject to a withholding tax has been a major obstacle to direct cross border holding of shares. This issue has been recently fixed by the EU legislator although it will take some time for the EU legislation to be applied.

At the same time, some issues are still not fixed and are getting even worse. There is a regulatory overload for companies with the Corporate Sustainability Reporting Directive (CSRD) although it applies to both listed and large non-listed companies.

However, the elephant in the room is the lack of money. There is an urgent need in the European Union to have pension funds investing in shares, like in the United States. There is no point in changing supervision or developing the best rules if there is not enough money to finance. This idea has been promoted by Fabrice Demarigny and made its way into the Letta report. This is the way forward. If water flows, an ecosystem will appear and establish its legal framework. There is a need to send water and the garden will flourish.

25 Enrico Letta, 'Much More Than a Market: Speed, Security, Solidarity', 17 April 2024 34 < <https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf> >.

26 Fabrice Demarigny, 'Strategic autonomy requires Capital Markets Union' (Le Grand Continent, 11 January 2024).

