cep Centrum für Europäische Politik
FREIBURG | BERLIN

cepInput Special

Europe in the Run up to the Election: Agenda 2024-2029 14 May 2024

The Quest for a Bold Capital Markets Union

Overcoming the Reluctance of EU Retail Investors to Participate in Capital Markets

Philipp Eckhardt and Anastasia Kotovskaia

© shutterstock_Giulio Benzin

The creation of a Capital Markets Union (CMU) is paramount in overcoming the many transformative challenges of our time, including the transition to a more sustainable, more digital or, lately, more secure and resilient EU economy and society. Numerous adjustments have been made in recent years but many more will be needed going forward. This special cepInput in the run-up to the European elections taking place between the 6-9 June will focus on the potential of fostering the participation of retail investors in capital markets. It will provide readers with three specific recommendations on how to resolve the current extreme hesitancy of European retail investors in this regard. We propose to

- radically simplify the current regulatory approach on incorporating sustainability preferences in financial advisory processes, to prevent these processes from actually becoming a barrier to investing,
- further explore the potential of implementing a 28th regime for financial services as an alternative regulatory concept for creating a single market for capital complementing the traditional path of a (gradual) harmonization of national financial sector legislation, and
- take renewed efforts to boost the financial literacy of European citizens in order to engage them in financial markets.

Preamble

Europe is facing a time of historical upheaval, a time of internal and external threats to peace and freedom, with great opportunities as well as risks from new technologies, and a time beset by the consequences of climate change and its impact on prosperity and justice. Today's Europe is the result of its eventful history, its experiences and the lessons it has learned from its scientific and cultural achievements, from its civilisational accomplishments, as well as from war, suffering and crisis. The legacy of the past has also given us a promise for the future: human dignity and freedom are inviolable. Today - in the face of major upheavals that will decide the fate and future of Europe - the question once again arises as to what solutions Europe can find to the troubles of the present and the challenges of the future. Can it preserve peace and freedom, defend its sovereignty and security, and increase prosperity and justice?

With this series of articles, the cep Network would like to draw attention to pressing issues and developments which go beyond day-to-day politics and regulation and will be of crucial importance for the EU in the run-up to a significant and game-changing European election. We aim to ask the key questions, shed light on their strategic context and provide some political answers.

Table of contents

1 What is at stake for the EU?...... 4

1.1 Investment needs and the status of the capital markets union 4

1.2 Why a capital markets union is so crucial for Europe's future prosperity 6

2 What is the strategic or conceptual problem for the EU? 8

2.1 Lack of participation in capital markets by retail investors...... 8

2.2 Why the reluctance to participate in capital markets is detrimental to CMU development 9

3 What are the smart solutions for the EU? 10

3.1 Quest No. 1: Simplify the advisory process on sustainability preferences 10

3.2 Quest No. 2: Further explore the value of 28th regimes for financial services...... 12

3.3 Quest No. 3: Boost the financial literacy of European citizens 13

Table of figures

Figure 1: Integration of the bond and equity markets in the EU 5

Figure 2: Banking sector in relation to the capital markets 5

Figure 3: Percentage of population with high level of financial literacy...... 14

This special cep**Input** sheds light on the importance of creating a Capital Markets Union (CMU) in order to overcome the many transformative challenges of our time, including the transition to a more sustainable, more digital or, lately, a more secure and resilient EU economy and society. While there are numerous adjustments that should and must be made to establish a single market for capital in the future, this publication focuses on the potential of fostering participation by retail investors in capital markets. It concludes by offering three specific ideas for the next European Commission, on how it could and should tackle the current extreme hesitancy of European retail investors in this regard.

1 What is at stake for the EU?

1.1 Investment needs and the status of the capital markets union

According to the EU Commission, € 620 billion per year in additional investments are needed to achieve the green transition, i.e. to meet the Green Deal and RepowerEU targets. Every year, € 125 billion are required for the digital transition.[1] To achieve the EU's connectivity targets for 2030[2] alone, the Commission anticipates investment needs totalling more than € 200 billion. And, at least since the start of the war in Ukraine, there has been a growing conviction of the inherent need to increase the EUs' defence capabilities and support Ukraine on many fronts. Also, the demographic changes that Europe is facing, and many other challenges, will make it necessary to raise expenditure and finance the many transformational revolutions that are taking place.[3,4,5] However, it seems clear that the money cannot be raised solely from public sources as most EU Member States' public budgets are under severe strain, not least due to the repercussions and aftermath of the corona pandemic and the energy crisis resulting from the war in Ukraine. On the contrary, it is inevitable that the EU will, in particular, have to mobilize a lot more private funds, an issue with enormous potential as, in 2023 alone, the EU's "excess of savings over domestic investment" was around € 370 billion.[6]

Currently, however, the potential is nowhere near being properly utilized. While there are multiple reasons for the failure to make use of private funding, one crucial reason is the EU's inability to form a genuine internal market for capital. Despite numerous political and regulatory efforts in recent decades and years[7], as well as multiple and renewed calls for further action[8], progress has been minimal or even non-existent. This is illustrated, for example, by the price-based indices developed by the ECB,

1 EU Commission (2023a), Strategic Foresight Report 2023, Sustainability and people's wellbeing at the heart of Europe's Open Strategic Autonomy.

2 The connectivity targets include the availability of a gigabit network connection up to the network termination point for all end users in the EU, and coverage of all populated areas with high-speed 5G wireless networks [Decision (EU) 2022/2481 of the European Parliament and of the Council of 14 December 2022 establishing the Digital Decade Policy Programme 2030].

3 EU Commission (2023a).

4 EU Commission (2024), White paper, How to master Europe's digital infrastructure needs?, COM(2024) 81, 21.2.2024.

5 Christine Lagarde, the president of the European Central Bank (ECB), recently stated that from 2031, there is a need of € 800 billion a year to meet the European greenhouse gas emission targets of a 90% reduction by 2040 and € 75 billion will be required a year to meet the NATO defense spending target of 2% of GDP.

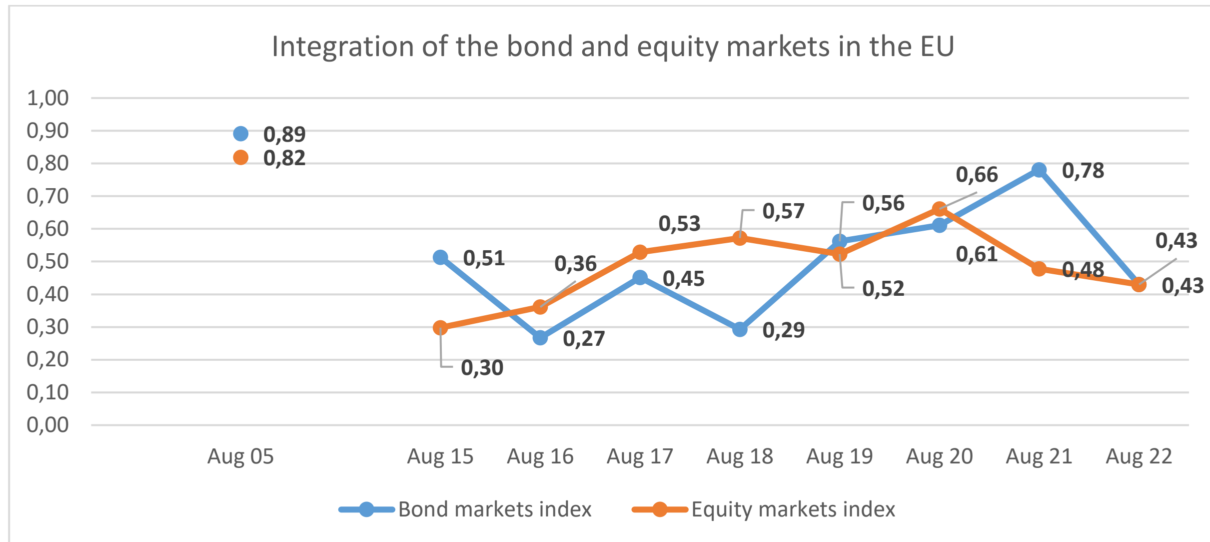
6 Banque de France (2024), From a Capital Markets Union to a genuine Financing Union for Transition, Speech by François Villeroy de Galhau, Governor of the Banque de France, Eurofi – Ghent, 23 February 2024.

7 For an overview of the many action plans adopted by the Commission as well as the many regulatory measures proposed and enacted take a look here. On several of such plans and measures, the cep also published dedicated analyses. They may be found here.

8 On 11 March 2024, the Eurogroup (in inclusive format) released a statement on the future of the Capital Markets Union. Shortly beforehand, on 7 March 2024, the Governing Council of the European Central Bank (ECB) published a statement on advancing the Capital Markets Union. On 8 October 2024, the European Parliament adopted a resolution on the "further development of the Capital Markets Union (CMU)".

which clearly show that there is no real momentum towards financial integration in the EU, but actually the opposite is true (see Figure 1).[9]

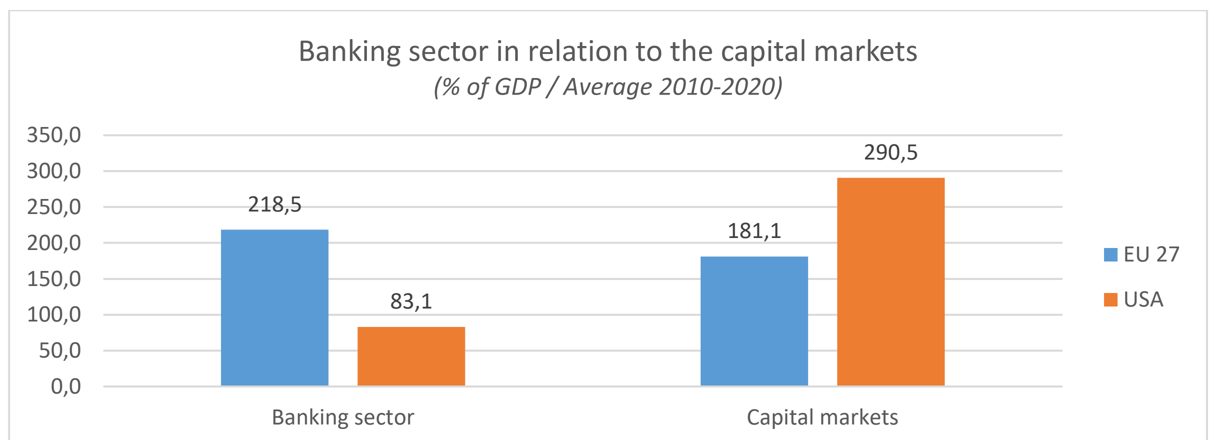
Figure 1: Integration of the bond and equity markets in the EU



Source: Sachverständigenrat (2023) based on ECB data

It can also be seen by depicting the importance of Europe's banking sector as compared with that of the capital markets, which is in striking contrast to the situation in the US. In the EU, most non-financial companies rely on financing via loans granted by credit institutions, while financing by way of capital markets is less common. The proportion of debt financing (vs. equity financing) is, thus, noticeably higher in the EU than in the US (55% v. 22%) (see Figure 2). And while only 21% of the liabilities of non-financial companies in the EU result from capital markets-based financing (listed shares and debt securities), the corresponding figure in the US exceeds 45%. On the other hand, non-capital-markets-based financing (non-listed equity and loans) in the EU amounts to roughly 66% of the liabilities of non-financial companies. In the US, it is a much lower 41%.[10]

Figure 2: Banking sector in relation to the capital markets



Source: Sachverständigenrat (2023)

9 Sachverständigenrat (2023), Wachstumsschwäche überwinden – In die Zukunft investieren, Jahresgutachten 2023/2024; ECB Indicators of financial integration and structure in the euro area.

10 Ibid.

Stock market capitalization is another good indicator of capital market integration. In this regard, data shows that market capitalization of listed domestic companies in the EU was at about 51% of GDP in 2018, while in the US it reached a remarkable 148%.[11] Also, bond markets in the US are three times larger than in the EU and the US venture capital markets are as much as five times larger than those in the EU.[12]

1.2 Why a capital markets union is so crucial for Europe's future prosperity

So, what is Europe missing out on by having a fragmented internal market for capital, low stock market capitalization and a strong reliance on bank financing? Unquestionably a lot! This is due to the many potential advantages of more integrated capital markets.

First, removing barriers to cross-border capital movements enables capital to flow to where it can be utilized most efficiently. Thus, it improves the allocation of capital such that it is received to a greater extent by companies and sectors that are able to use it in the most productive manner.[13]

Second, dismantling these barriers improves risk sharing. More integrated capital markets offer companies more (cross-border) financing options. Risks can, thus, be more easily diversified among a wider range of investors and between countries. Furthermore, it supports a more effective way to cushion (local, country-specific) shocks, as losses can be more easily shared in the case of cross-border holdings of equity as compared with cross-border credit holdings.[14] Capital markets in the US, for example, are capable of cushioning 30-35% of state-specific shocks, while in the euro area they are only able to cushion 10-15%.[15]

Third, a capital markets union may strengthen competition by making it easier for companies to offer their financial products and services across borders, and for potential customers to demand products and services from businesses in other EU Member States. Thus, fewer burdens in this regard offers new business opportunities for firms, more choice and access to innovation for customers and, ultimately, lower prices.[16,17] What is more, an integrated European capital market may level the playing field among European companies in need of capital as it may allow for more equivalent financing conditions for similar or comparable companies.[18]

Fourth, in comparison to banks, capital markets are generally more suited to financing innovative economic activities and providing young firms with financial means, as well as supporting risky investments, e.g. via private equity or venture capital. Banks are often not capable of providing financing to these types of firms and projects due to their lack of sufficient track record and of tangible assets that

[11] World Bank, World Development Indicators, Market capitalization of listed domestic companies (% of GDP).

[12] European Central Bank (2023), A Kantian shift for the capital markets union, Speech by Christine Lagarde, President of the ECB, at the European Banking Congress Frankfurt am Main, 17 November 2023.

[13] cep (2016a), cepPolicyBrief No. 1/2016 on a Communication by the Commission [COM(2015) 468] on an "Action plan on a capital markets union".

[14] Deutsche Bundesbank (2015), Deutsche Bundesbank's reply to the European Commission's Green Paper "Building a Capital Markets Union".

[15] European Central Bank (2024), The euro at 25: what next for Economic and Monetary Union?, Introductory remarks by Piero Cipollone, Member of the Executive Board of the ECB, at the European Parliamentary Week 2024, 12 February 2024.

[16] cep (2017), cepPolicyBrief No. 2017-20 on a Communication by the Commission [COM(2017) 139] on a "Consumer Financial Services Action Plan: Better Products, More Choice".

[17] cep (2016b), cepPolicyBrief No. 2016-09 on a Green Paper by the Commission [COM(2015) 630] on retail financial services.

[18] Issam, H (2024), Capital markets union: Overview and state of play, European Parliamentary Research Service, February 2024.

could be pledged as collateral. Thus, bold capital markets are vital to serve these growing needs and thereby strengthen Europe's (long-term) productivity.[19]

Fifth, the ability of the real economy to fall back on liquid capital markets simply offers companies an important funding alternative. This, in turn, not only allows them to improve their financing mix but can serve as a kind of insurance in case credit markets come under severe strain, such as e.g. after the financial crisis in 2008 and 2009.[20] Economies that are overly reliant on bank funding appear to be more susceptible to crisis, which negatively affects financial stability.[21] The shock-absorbing capacity of banks is particularly impaired during a financial crisis and ultimately leads to more severe recession as compared to markets-based economies.[22]

And, most importantly, research shows that economies with deeper and more liquid capital markets grow faster. Econometric estimates demonstrate that there is "a positive and statistically significant correlation between capital market development and GDP growth or total factor productivity"[23]. This applies especially, when coming from a low level of markets-based funding.[24] Conversely, additional bank lending often even has the opposite effect, at least in jurisdictions that already have a large banking sector like most European economies. By implication, a shift away from bank-centricity towards stronger capital markets, or establishing a bold capital markets union as a complementary element to lending-based financing, could be conducive to growth.[25]

[19] Deutsche Bundesbank (2015); Sachverständigenrat (2020), Corona-Krise – Gemeinsam bewältigen, Resilienz und Wachstum stärken, Jahresgutachten 2020/2021; IMF (2023), IMF Background Note on CMU for Eurogroup, June 15, 2023.

[20] Deutsche Bundesbank (2015); Federal Ministry of Finance (2023), A French-German roadmap for the capital markets union, 13.09.2023.

[21] Demertzis, M., Domínguez-Jiménez, M., & Guetta-Jeanrenaud, L. (2021). Europe should not neglect its Capital Markets Union (No. 13/2021). Bruegel Policy Contribution.

[22] Gambacorta, L., Yang, J., & Tsatsaronis, K. (2014), Financial structure and growth, BIS Quarterly Review March.

[23] Sachverständigenrat (2023).

[24] The initial positive link between a deeper capital markets and GDP growth may also become negative in case the markets are already very strong. However, most European economies are below that threshold.

[25] Cournède, B., & Denk, O. (2015). Finance and economic growth in OECD and G20 countries; Gambacorta, L., Yang, J., & Tsatsaronis, K. (2014).

2 What is the strategic or conceptual problem for the EU?

There are a number of reasons for the underdevelopment of European capital markets. They range, among other things, from different tax laws and insolvency regulations in the Member States, to inconsistent supervisory requirements and cumbersome stock exchange listing provisions. One key aspect that will be discussed in more detail below, and which is also a cause of the weakness of the European single market for capital, is the unwillingness of retail investors to actually utilize the opportunities that the capital markets can offer them. Unlocking this potential must be the primary pillar of a successful capital markets union.

2.1 Lack of participation in capital markets by retail investors

Europeans know how to save. Their savings rate is one of the highest in the world and even outstrips that of the USA.[26,27] However, their savings behaviour is often not conducive either to their own interests or to the economic development of the European economies. Instead, it is regularly characterized by risk aversion and caution. This is illustrated by just a few statistics:

In Germany, for example, while 70% of citizens save, they favour call money accounts, fixed-term deposit accounts and savings books. Only 19% invest in securities.[28] In 2022, private households in the EU held an impressive 33.9% of their financial assets in cash and bank deposits.[29] By comparison, the ratio in the USA was only 13.4%.[30] Likewise, in 2021, households in the 27 Member States held only 17% of their financial assets in securities, while the proportion for US households was around 43%.[31] The equity market participation of households was 58% in the USA in 2022, while it was only around 18% in Germany. [32]

There are many reasons for the low level of capital market participation among Europeans. Surveys show that the security of the investment plays a central role, but also the rapid availability of the invested funds.[33] It is true that a large proportion of EU households do not make any financial investments due to a lack of financial assets (47%). However, the remaining households are highly risk averse. For example, 21% have concerns about the risks associated with an investment and 15% doubt that they will be able to achieve a satisfactory return. In addition, 14% shy away from investing due to the high level of complexity and 12% have no confidence in investment advice.[34] A lack of financial education is also likely to be a significant factor[35], as is investors' low level of trust in the capital markets, which has suffered in particular as a result of the 2007/2008 financial crisis and the shocks caused by the coronavirus pandemic. Furthermore, reference is regularly made to the high transaction costs and the information asymmetries when investing in securities between investors and issuers, as well as the

---

[26] EU-Commission (2023b), Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Long-term competitiveness of the EU: looking beyond 2030, COM(2023) 168, 16.3.2023.

[27] Between 2013 and 2019, for example, EU households saved an average of 12.4% of their gross disposable income. In contrast, retail investors in the US only set aside around 7.2% [Annunziata, F. (2023), Retail Investment Strategy. How to Boost Retail Investors' Participation in Financial Markets, July 7, 2023].

[28] Commerzbank (2024), Commerzbank investment study: Most Germans save too much and invest too little, 28.2.2024.

[29] In Germany, the proportion is even higher at 42.8%.

[30] Sachverständigenrat (2023).

[31] EU-Commission (2023c), Commission Staff Working Document, Impact Assessment report, Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules, SWD(2023) 278, 24.5.2023.

[32] Sachverständigenrat (2023).

[33] Commerzbank (2024).

[34] EU Commission (2022), Eurobarometer 509, Retail financial services and products, October 2022.

[35] See e.g. OECD (2020), OECD/INFE 2020 International Survey of Adult Financial Literacy.

fact that deposits are partially protected by deposit protection, for example, whereas there is no such protection for securities investments.[36]

2.2 Why the reluctance to participate in capital markets is detrimental to CMU development

This ultimately shows a strong affinity of EU households towards highly liquid products with low interest rates over time.[37] However, this tendency runs counter to the central objectives of the Capital Markets Union because the transformative step towards secure, resilient, sustainable and digital European economies requires massive investment in numerous areas which is often indispensable (see above). To finance these investments, recourse to state financial resources is also necessary. However, the contribution of the private sector and therefore also the support of the large number of European small investors is much more decisive. Europe's ability to leverage this (financing) potential, which has so far only been realized to a limited extent, would be a key factor for a flourishing EU economy and a successful transformation. Only if the EU manages to fully utilize this potential, or at least to a far greater extent than before, will it also succeed in converting the high savings of European households into productive investment opportunities. Greater capital market participation by small investors would indirectly open up an additional financing option for numerous borrowers and therefore EU companies - in addition to the bank financing that is currently very prevalent in Europe. However, if this does not materialize and retail investors continue to remain in low-interest financial products outside the capital markets, it will be almost impossible to generate additional private capital for the numerous challenges. It would also offer numerous opportunities for small investors themselves. In the long term, they would benefit from higher returns, a lower risk of loss and make an important contribution to securing their own retirement provision.[38] The removal of barriers and the creation of incentives for greater capital market participation is therefore in the vital interest of both investors and borrowers and is a cornerstone for the future completion of the Capital Markets Union.

[36] EU Commission (2015), Commission Staff Working Document, Economic Analysis, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Building a Capital Markets Union, SWD(2015) 183, 30 September 2015.

[37] Federal Ministry of Finance (2023), A French-German roadmap for the Capital Markets Union, 13.09.2023.

[38] Sachverständigenrat (2023).

3 What are the smart solutions for the EU?

As explained, greater capital market participation by EU households can also contribute to the completion of the Capital Markets Union, even if this is only one building block among many. Thus, measures to overcome the reluctance of retail investors in investing on capital markets are vital. In the following, we present three ideas on how more EU citizens could be encouraged to participate in the capital markets.

3.1 Quest No. 1: Simplify the advisory process on sustainability preferences

Under current EU law, investment advisors are obliged to check whether a financial product is suitable for a client.[39] Until August 2022, this suitability assessment required them to obtain information on the client's willingness to accept and tolerate risk, their ability to bear losses and their investment experience. Since then, they have also had to ask customers about their sustainability preferences as part of the advisory process. They are only allowed to recommend financial products that are in line with the customer's sustainability-related investment objectives. The investment advisor must first ask the customer whether they generally wish to invest their money in a sustainable manner. If this is the case, the customer should be able to choose between three forms of sustainable investment by indicating whether they are aiming for a product which[40,41]

- includes a certain minimum proportion of environmentally sustainable investments within the meaning of the Green Taxonomy Regulation,
- includes a certain minimum proportion of environmentally sustainable investments within the meaning of the Disclosure Regulation, and/or
- takes account of the most important adverse effects on sustainability factors.[42]

At first glance, the inclusion of potential sustainability preferences in financial advice has the specific purpose of ensuring that financial and capital flows are directed towards sustainable investments. However, this "nudging approach", which has been pursued for almost two years now, should be rejected, and not just because it is paternalistic in nature and represents undue interference with investors' freedom of choice.[43,44] In practice, obtaining sustainability preferences is (1) too complex, (2) too time-consuming, (3) ineffective and ultimately (4) counterproductive for increasing the participation of small investors in the capital markets.

Firstly, investment advisors themselves often have difficulty grasping the above-mentioned sustainability concepts. Secondly, explaining them to potential retail investors is not a trivial matter. Furthermore, it is doubtful whether retail investors - broadly speaking - actually want to understand and internalize the concepts in any depth in order to be able to make well-founded decisions. If they do not have this in-depth interest, however, there is a great risk that they will lose interest in sustainable

---

[39] Directive 2014/65/EU on markets in financial instruments (MiFID).

[40] Commission Delegated Regulation C(2021) 2616.

[41] Similar requirements also apply to insurance companies and insurance intermediaries that offer advice on insurance investment products [Insurance Distribution Directive (EU) 2016/97, Commission Delegated Regulation C(2021) 2614].

[42] In particular, this excludes financial products that have a negative impact on sustainability, e.g. the emission of greenhouse gases [Bafin (2019), Thema Verbraucherschutz, Geeignetheitserklärung: Wichtiges Dokument für Verbraucher, 8.09.2018].

[43] According to a study by Commerzbank AG, the topic of "sustainability" is only in 9th place as an investment selection criterion at 10%. Much more important to investors are the topics of "security" (52%), "availability" (39%) and return (35%). [Commerzbank AG (2024), Most Germans save too much and invest too little, Investment Study 2024 - How Germany invests].

[44] According to a survey by Ipsos, around 28% of respondents want to make their investments sustainable due to climate change, and 49% of young Generation Z [Ipsos (2024), Financial survey: Gen Z invests sustainably, January 29, 2024].

investments per se. Secondly, asking about sustainability preferences and explaining the three sustainability concepts in easy-to-understand language is very time consuming. In practice, a consultation regarding a customer's decision on a sustainable investment therefore takes considerably longer. This time aspect creates unintended disincentives. The advisor will push the potential client towards a less time-consuming non-sustainable investment. Likewise, the client will prefer to avoid bureaucratic sustainability-oriented advice. Thirdly, the complexity and additional time required means that even small investors who are actually interested in sustainable investments will refrain from responding because the process of dealing with the issue is too lengthy. The element of querying sustainability preferences in the advisory process does not therefore lead to increased transformative capital reallocation in the sustainable sense but may even have the opposite effect. And fourthly, there is a risk that frustration with the cumbersome advisory process will deter potential investors from making an investment at all.[45] In this case, neither the desire for greater sustainability nor the goal of attracting more citizens to the financial markets is satisfied.[46]

Conclusion and recommendation for action: The aim of encouraging sustainable investments by giving greater consideration to sustainability aspects in the advisory process may have been well-intentioned but is ill-conceived. Even if one considers the use of nudging in investment advice to be sensible and expedient - we do not[47] - it is clear that the approach chosen by the Commission is the wrong one. It neither serves the intended purpose of encouraging sustainable investments nor does it contribute to greater capital market participation by small investors. This means that a change of direction is the order of the day.[48] The legislative processes currently underway, which the Commission initiated last year as part of the presentation of its EU retail investor strategy, lend themselves to such a change of direction.[49] The advisory process for financial investments needs to be noticeably streamlined and less complex. In addition, the greatest possible coherence and consistency with existing and future information obligations, such as those for key information documents as part of the revision of the PRIIPs Regulation, must be ensured. One promising starting point here is the "ESG scale", developed by the Sustainable Finance Advisory Board, which provides information on the ESG characteristics of financial products in a simple and easy-to-understand way. This could be incorporated into the revised key information documents and become a central point of reference in the advisory process. Only with the help of such or similar instruments can trust and a greater "appetite" for economically desirable (sustainable) investments on the part of small investors be (re)created as a building block for deepening the Capital Markets Union.

[45] See e.g. Forum Nachhaltige Geldanlagen (FNG), Press statement: Sustainability query under MiFID II currently not expedient, 14.09.2023.

[46] According to a recent survey by the Center for Financial Studies (CFS), only 21.4% of survey participants believe that the existing form of taking sustainability goals into account makes sense. In contrast, 74.5% of participants are convinced that many customers are overwhelmed by the complexity of the issue [Center for Financial Studies, CFS Index, Survey Q1 2024, 29.02.2024].

[47] Market-based approaches such as emissions trading or direct regulatory requirements are more effective than turning away from "unsustainable" economic activities indirectly via the financial markets and by means of the sustainable finance legislation propagated and implemented by the EU (green taxonomy, disclosure regulation, sustainability reporting directive, etc.).

[48] See also Sustainable Finance Advisory Board of the German Federal Government (2024), Final recommendation for the introduction of an "ESG scale" for financial products.

[49] As part of the strategy (see cepStudy), the MiFID Directive, the Insurance Distribution Directive (IDD) and the Regulation on key information documents (PRIIP Regulation) in particular will be subject to a review.

3.2 Quest No. 2: Further explore the value of 28th regimes for financial services

For many, many years, a central regulatory concept for creating a single market for capital has been the (gradual) harmonization of national legislation in the financial sector, for example in the area of consumer and investor protection. However, this path regularly proves to be laborious, and it is evident that both the cross-border supply and the cross-border demand for financial products and services continue to fall short of expectations in many cases.

Another concept that is discussed at regular intervals and represents an alternative to the constant harmonization of national law is the construct of a "28th regime". Ultimately, such a regime is an optional EU legal framework, which is additional to existing national legislation, leaves it untouched and therefore does not attempt to harmonize it.[50] Such a 28th regime enables the players concerned - financial companies and potential customers - to either opt for the application of the uniform EU regime or to continue to be subject to national requirements. If contractual partners in the financial sector take the first option, they will no longer have to deal with 27 different legal systems for cross-border transactions (or only to a limited extent), but will be able to conclude their contracts on the basis of uniform EU-wide requirements.[51] The EU Commission also recognized the potential of a 28th regime back in 2015 in a Green Paper on the creation of a Capital Markets Union[52] and later in a Green Paper on retail financial services[53]. In June 2019, it further enshrined the regime with the creation of so-called "pan-European private pension products (PEPP)".[54] PEPPs are intended to supplement existing statutory and occupational pension systems and products and neither replace nor harmonize existing national private pension products and systems.[55] In its proposal on "European crowdfunding service providers for companies", the Commission also proposed the establishment of uniform EU-wide regulations on crowdfunding in the form of an optional 28th regime, whereby crowdfunding service providers should be able to decide whether they want to apply EU or national regulations[56].

Conclusion and recommendation for action: In order to make the single market for capital a reality, the EU should continue to examine whether recourse to a 28th regime makes sense. As a rule, it at least offers the potential to facilitate the free movement of EU citizens and to promote cross-border competition. It could also reduce the cost of cross-border financial products and services, help to reduce barriers to market entry and ensure better use of economies of scale. Furthermore, the comparability of all financial products and services covered by a 28th regime may be improved. Its optional nature could also lead to fruitful competition between the different regulatory approaches – EU v.

[50] It is referred to as the 28th regime because it would exist in addition to the legislation of the 27th Member State.

[51] European Economic and Social Committee - Opinion on 'The 28th regime - an alternative for less regulation at Community level', 2011/C 21/05.

[52] It states: "Personal pensions are the subject of several pieces of EU legislation. This raises the question of whether the introduction of a standardized product (e.g. via a pan-European or "29th" scheme), while removing barriers to cross-border access, would strengthen the single market for personal pensions." [p. 19, COM(2015) 63, Green Paper, Creating a Capital Markets Union, 18.2.2015].

[53] It states: "A voluntary opt-in regime could provide the framework for products with identical characteristics. It would provide standardized requirements across Member States and overcome many regulatory differences between them in some areas. It could also be a useful tool to enable the provision of comparable and easily understandable financial products, which would boost consumer confidence and their willingness to buy a product abroad." [p. 34, COM(2015) 630, Green Paper on retail financial services - Better products, more choice and more opportunities for consumers and businesses, 10.12.2015].

[54] Regulation (EU) 2019/1238 of the European Parliament and of the Council of June 20, 2019 on a Pan-European Private Pension Product (PEPP).

[55] Recital 19, Regulation (EU) 2019/1238.

[56] Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers for Businesses, COM(2018) 113, 8.3.2018.

national. Admittedly, 28th regimes are not a direct route to greater integration of the single capital market, as it is likely that different requirements, for example in tax law, will nevertheless persist. However, an in-depth examination of this regulatory approach would be helpful in order to counter the persistence of barriers in the single market for capital. A first possible starting point here would certainly be the idea recently put forward at the informal meeting of EU finance ministers of developing a "legal framework for uniform market-based savings products", which should be subject to "uniform and harmonized tax treatment in all Member States".[57,58,59] Even if such a legal framework, which could be based on the construct of a 28th regime, still requires more detailed preliminary studies and impact assessments, it could contribute to a stronger shift of small investors towards the capital markets and take them away from bank deposits and a less productive attitude towards cash. At the same time, it could facilitate diversified and cross-border capital investment and thus strengthen the resilience and stability of the capital markets.

3.3 Quest No. 3: Boost the financial literacy of European citizens

Financial literacy is a requirement for individual engagement within capital markets, predominantly through investment in stocks, bonds, and various other financial instruments. Moreover, with the increasing complexity and variety of financial products and services, financial knowledge is increasingly becoming essential in the modern world. Citizens are also finding it more challenging to decide which financial products or services meet their needs or suit their risk tolerance. Consequently, insufficient financial knowledge poses a barrier for individuals seeking to invest in financial markets. At the same time, enhanced comprehension of capital market mechanisms increases the willingness of individuals to allocate their savings to capital markets and helps in the making of justified investment choices. A high level of financial knowledge further prevents irrational behaviour such as panic selling and thus engenders stability within capital markets.[60]

Financial literacy is a fundamental life skill fostering financial well-being for both individuals and society.[61] In its broadest sense, financial literacy covers not only the understanding of basic financial concepts (i.e. investing, saving, budgeting and debt) but also encompasses being able to make reasonable financial decisions, being resilient to financial fraud and scams, and possessing the digital skills necessary to deal with the digitalization of financial markets.

Regrettably, only around 34% of adults worldwide exhibit proficiency in the basics of financial literacy.[62] Within the EU, 18% of EU citizens possess a high degree of financial literacy, while 64% have a moderate level, and the remaining 18% exhibit low levels of proficiency. However, significant disparities exist among Member States. Only four Member States, namely the Netherlands, Sweden,

---

[57] Belgian Presidency of the Council of the European Union (2024), Issues note of the informal Ecofin on EU competitiveness, Meeting of EU Finance Ministers and Central Bank Governors, 23rd and 24th February 2024, KAA Gent Arena.

[58] Vincent Van Peteghem (2024), Key Takeaways from the Informal Ecofin Meeting in Ghent, Press Release, February 24, 2024.

[59] In this context, his French counterpart Bruno Le Maire, Minister for Economic Affairs and Finance, advocates launching such a European savings product this year and, if necessary, initially only introducing it in selected member states that are open to it [Werner Mussler and Niklas Záboji (2024), Frankreich verliert bei Kapitalmarktunion die Geduld, Frankfurter Allgemeine Zeitung (FAZ), 23.02.2024].

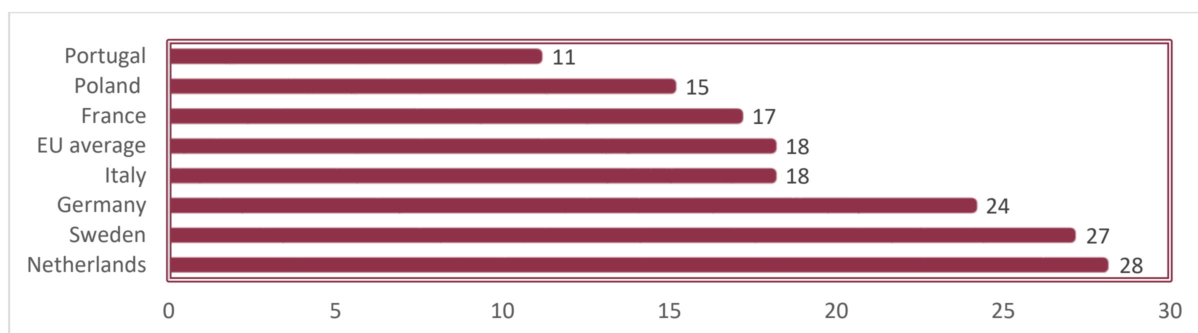
[60] Lusardi, A. and O.S. Mitchell (2023), The Importance of Financial Literacy: Opening a New Field, Journal of Economic Perspectives 37(4): 137-154.

[61] G20 (2021), Italian G20 Presidency Third Finance Ministers and Central Bank Governors Meeting Communiqué, available here.

[62] As delineated in a recent report published by the Organisation for Economic Cooperation and Development, OECD/INFE (2023), International Survey of Adult Financial Literacy, available here.

Denmark and Slovenia, have more than 25% of their populations scoring highly in financial literacy (see Figure 3).[63]

Figure 3: Percentage of population with high level of financial literacy



Source: European Commission (2023).

The level of financial literacy rises in line with GDP per capita and educational level.[64] Moreover, enhanced financial literacy correlates with increased personal financial stability.[65] Accordingly, insufficient financial knowledge creates vulnerabilities that weaken economic stability.[66] Advanced financial knowledge has a significant impact on participation in the stock market.[67] Considering its economic significance, financial literacy can be viewed as a supplementary element to financial regulation. We need to create an opportunity for EU citizens to increase their participation in the CMU. Even so the EU lacks the competence to intervene in education policy; non-regulatory actions to improve the financial knowledge of EU citizens would be desirable.

First recommendation for action: We are calling for regular monitoring of the level of financial literacy as well as analysis of progress, using comparable data on financial literacy levels across all EU countries. There is a need for a single methodology for measuring financial literacy. The EU Commission made its first attempt to conduct a survey to measure the level of financial literacy in the EU Member States in 2023.[68] Currently, the Commission's survey includes five areas: inflation, compound interest, asset pricing, correlation between risks and returns and risk diversification. We suggest adding further areas of knowledge that should be evaluated: additional provision for old age (alongside to the statutory retirement plan); managing debts and loans; the main financial instruments and options for participating in capital markets and digital competencies with regard to financial markets participation. Moreover, the questions posed should go beyond simple self-assessment of proficiency in those topics but also include questions which actually test a person's knowledge.

Second recommendation for action: We are calling for the development of a single EU financial literacy strategy. Some EU countries have already made an effort in developing programs to strengthen financial knowledge. Those ideas should be coordinated and best practices among Member States identified. For instance, financial education should be available for Individuals of all ages and socioeconomic backgrounds, and should start from an early age to equip young adults with essential financial

[63] European Commission (2023d), Monitoring the level of financial literacy in the EU, Flash Eurobarometer 525, available here.

[64] See OECD/INFE (2023) and European Commission (2023d).

[65] OECD/INFE (2023), p. 56.

[66] Batsaikhan, U. and M. Demertzis (2018), Financial Literacy and Inclusive Growth in the European Union, Policy Contribution 08/2018, Bruegel, available here.

[67] See research conducted on Dutch households in Van Rooij, M., A. Lusardi and R. Alessie (2011), Financial literacy and stock market participation, Journal of Financial Economics 101(2): 449-472.

[68] European Commission (2023d).

literacy skills. Free or low-cost financial education programs and workshops could be offered in local educational organizations, libraries, and via online services. Bolstering the shareholder culture could be achieved through enhancing the informational transparency of retail investment and insurance-based products.

Third recommendation for action: We are calling for the creation of a single EU online portal for increasing and testing financial literacy. The EU-wide platform could offer a wide range of educational materials covering various aspects of finance, including infographics, interactive tutorials, case studies. Testing user understanding of financial concepts could take place by way of quizzes and the results could further facilitate progress in financial literacy level. To meet the needs of all EU citizens, the platform should be accessible in all EU languages.

Authors:

Philipp Eckhardt, Division on Financial Markets
eckhardt@cep.eu

Dr. Anastasia Kotovskaia, LL.M., Division on Financial Markets
kotovskaia@cep.eu

Centrum für Europäische Politik FREIBURG | BERLIN
Kaiser-Joseph-Straße 266 | D-79098 Freiburg
Schiffbauerdamm 40 Räume 4205/06 | D-10117 Berlin
Phone + 49 761 38693-0

The **Centrum für Europäische Politik** FREIBURG | BERLIN, the **Centre de Politique Européenne** PARIS, and the **Centro Politiche Europee** ROMA form the **Centres for European Policy Network** FREIBURG | BERLIN | PARIS | ROMA.

The cep institutes are specialised in the analysis and evaluation of European Integration Policy. They publish their scientific work independently of any vested interest, in favour of a European Union that respects the Rule of Law and the principles of the social market economy.