
Integration of EU Capital Markets

AFME response to European Commission Consultation – Executive Summary

JUNE 2025

AFME welcomes the opportunity to respond to the Commission's targeted consultation on integration of EU capital markets. Our members share the ambition of building deeper and more liquid markets that are competitive on a global level.

We acknowledge that the Commission's consultation is seeking to understand what the potential issues are across every part of the trade lifecycle, reflecting that issuance, trade execution, and post trade exist on a continuum rather than as distinct processes. At the same time, we encourage eventual legislative proposals are targeted to address the most pressing policy priorities to improve the European financing ecosystem to the benefit of corporates and citizens.

Building deeper and more liquid securities markets in the EU is first and foremost a 'demand' issue. The AFME membership shares the EU's ambition to support the growth of retail participation in the region but strongly believe that many of the proposals related to equity market structure are not conducive to that end. At this stage, radical changes to microstructure (such as the idea of introducing an order protection rule) are highly undesirable and will portray the region as being in a state of constant regulatory flux, when investors, including those newly attracted to Europe in light of recent geopolitical trends, need stability, predictability, and consistency. Such changes will also burden all market participants with considerable implementation and compliance costs, with no clear growth opportunities attached to such investments.

Instead, we recommend focusing efforts on:

1. Encouraging retail participation, which requires decisive action across member states in support of the broader objectives of the Savings and Investment Union. In July 2024, AFME put forward proposals to develop larger pools of long-term capital¹. For example, to encourage members states to build their supplementary pension systems by promoting auto-enrolment with opt-out options combined with tax incentives., promote an investment culture and financial education, and to take further steps towards harmonising tax and securities law frameworks across the region.

2. Improving competition for the provision of post-trade FMI services should be the critical objective of the new legislative proposal. In the clearing space, interoperability of clearing houses is viewed by AFME members as a critical aspect to foster competition. Competition is also needed at the level of CSDs where fragmentation along national lines persists. This has a disproportionate cost impact on smaller market participants and results in high frictional costs. To remedy to this situation, AFME proposes increasing competition by enhancing price transparency, unlocking the potential of new technologies (including DLT), exploring the potential establishment of a common pan-EU issuance layer between issuers and domestic CSDs and supporting further harmonisation of the legal, regulatory, and operating environment. We strongly believe that DLT offers an unprecedented opportunity to achieve longstanding goals to integrate capital markets through

¹ https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_IntegratingEUUCM_11-1-1.pdf

upgrading and redesigning financial infrastructures, as well as increasing competition through new innovative business models.

3. Simplification of EU regulatory framework. Whilst current rules are critically assessed as to their effectiveness at delivering on their core policy objectives, simplification also means conducting an in-depth reflection to assess how the Lamfalussy process is functioning. The EU should seek to put in place a more agile and effective regulatory and supervisory approach for globally competitive banking and capital markets. We are of the view that the EU needs to enhance its rule-making agility particularly for wholesale capital markets. This has the potential to improve EU competitiveness. To a certain extent simplification could also take the form a more integrated EU supervision for some market infrastructures, provided ESAs' governance, objectives and powers are adequately reformed, as such development can contribute to reducing cross border frictions and be an enabling factor to apply the single capital market rulebook in a consistent manner.

We strongly recommend that the above-identified areas should be the focus of eventual legislative proposals. It is also important to acknowledge that regulatory stability must be the objective in areas where urgent policy actions are not immediately needed. AFME calls for a selective but impactful series of reforms.

In this context, AFME emphasises that the EU is unlikely to achieve our shared ambition for growth by fundamentally transforming the regulatory framework for equities trading, and replicating market structure features of other jurisdictions with different geographies, legislative frameworks, issuer and investor bases, and politics.

Instead, we must embrace the EU's unique operating environment, and deliver targeted changes to address inefficiencies and build on what works well. These changes should be focused on four key principles, elaborated on in the 'Recommendations' section of this summary, and our full response to the consultation:

Investor-focused – recognising the instrumental role that institutional investors play in channelling EU retail savings' to productive investments while encouraging enhanced participation from retail investors by delivering better access and outcomes.
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Competitiveness – identifying areas where user choice is restricted and take appropriate action to unlock competition, leading to innovation and cost reduction.

Interoperability - promoting industry-driven “functional harmonisation”, moving closer to a single European model.

Simplification – conducting an in-depth assessment of the regulatory acquis to identify opportunities to streamline the rules that are not necessary to deliver on core policy objectives, and only serve to add costs and complexity for market users. We also welcome a careful review of how EU rules at all levels are produced.

POST TRADE

Several influential recent reports (Draghi, Noyer, Letta) have identified that the post-trade financial market infrastructure in the Union is complex, fragmented and suffers from a lack of competition between providers. AFME supports this analysis and believes that improving competition for the provision of post-trade FMI services should be the critical objective of the new legislative proposal. The cost of maintaining separate post-trade infrastructures hinders efficient trading and investment. This erodes return on investment, and

contributes to making Europe a less attractive place to list and invest, in particular for smaller market participants such as retail investors. It also impacts how quickly Europe can adapt to change. A prime example is the move to T+1, which -unlike in other integrated markets- requires a simultaneous and very complex coordination between over 40 infrastructures CCPs, CSDs and T2S.

AFME's preliminary analysis, based on publicly available fee schedules, indicates that the fees charged by European CSDs for the provision of settlement and custody services are significantly higher than other major capital markets. Further, there is substantial variation in the fees charged by different CSDs within the CSDs, and a lack of comparability in how fee schedules are structured.

It is to be noted that while intermediaries have over the years been able to reduce the fees they charge to clients through optimisation of processes, investment in systems, and competitive pressures, the CSDs have not followed. In certain cases, CSD fees have increased, despite the creation of T2S as a common infrastructure layer designed to generate scale and efficiency and reduce costs. This not only impacts intermediaries, but ultimately disadvantages end users of capital markets – issuers and investors, including the retail segment.

In the aforementioned reports, it was suggested that the solution to this issue was through consolidation into a single pan-European CSD, potentially leveraging T2S. Whilst this utility-type model is used in other major financial markets, to good effect, it is not clear that this is a realistic way forward for the EU, for a variety of practical, regulatory and political reasons.

The more realistic way forward for Europe is true competition between FMIs, which would result in a reduction in costs, an increase in innovation and, ultimately, to market-driven consolidation. Competition in trading, where a diversity of execution mechanisms exist, has been highly successful in driving innovation, bringing down transactional costs, and promoting user choice. This is inherently more complex for post-trade, where CSDs provide both issuer services (initial creation of the securities and maintenance of the register, processing of corporate events) and “market-side” services (safekeeping and settlement of assets). As per CSDR, these services can only be provided by authorised CSDs, meaning they have a quasi-monopolistic position once they have been selected by the issuer. In the current market construct, the issuance services for any one security can only be provided by one CSD (the “issuer CSD”). Although “market-side” services can be provided by another CSD (“investor CSD”), they can only do this by connecting to, and paying, the issuer CSD.

In other words, market participants cannot have a truly free choice of which CSDs to use – its largely determined by the selection of the CSD by the issuer – and investor CSDs cannot fully compete on a level playing field with the issuer CSD for the provision of “market-side” services.

Addressing this fundamental challenge requires a multi-faceted approach. We continue to support the eradication of any and all barriers to the provision of cross-border issuance, with further harmonisation of the legal and regulatory environment necessary to ensure CSDs can compete on a level-playing field. However, it must be acknowledged that competition for CSD issuance services does not create competition for safekeeping and settlement services. An important first step is increased regulatory focus on the charging of these core services, ensuring that they are fair and transparent. Greater uniformity in how CSDs' public fee schedules are presented, allowing users to accurately compare different providers, is a critical pre-requisite of unlocking competition.

More ambitiously, more structural changes could be envisaged to foster competition between CSDs for the provision of market-side services, by levelling the playing field for issuer services. Any consolidation of market infrastructure should not result in monopolistic positions for commercial entities. Subject to further analysis

as to the feasibility, a common issuance layer (i.e. a notary/registration function) which would allow issuers to issue securities across the EU, and to which all EU CSDs could connect, could facilitate true competition between CSDs for safekeeping, asset servicing and custody services, and allow market participants choice as to which providers to connect to. This role could potentially be played by T2S without requiring T2S to become a CSD in its own right. It could also simplify the complexity of cross-CSD settlement, largely leveraging existing T2S functionality.

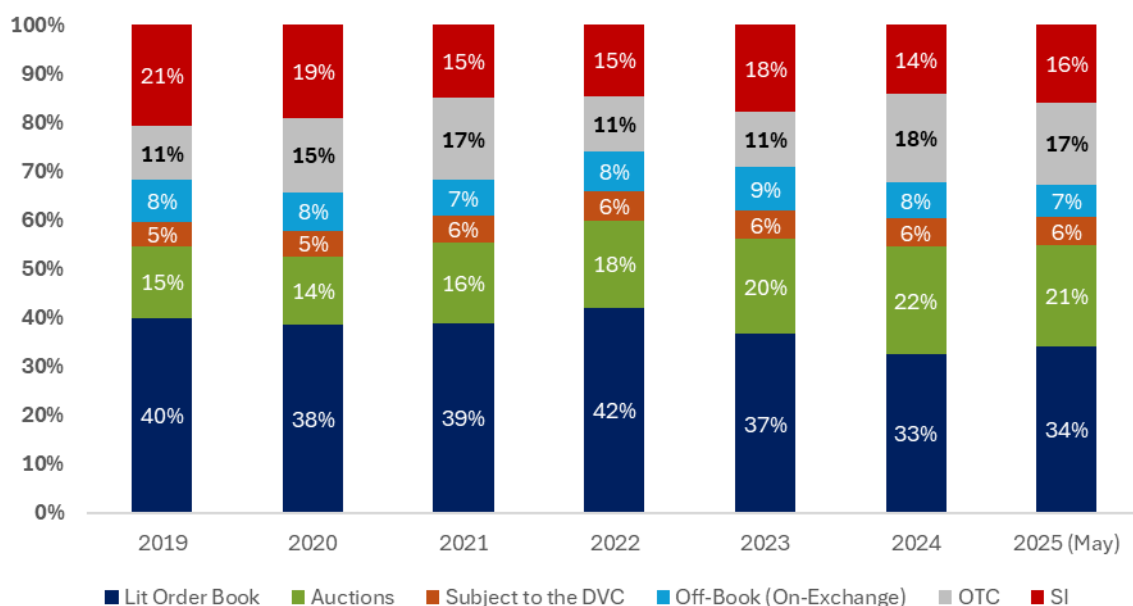
With respect to clearing, existing interoperability arrangements by certain CCPs have been hugely successful in driving down fees for cash equities clearing, estimated to be at least 50%, reducing the cost of transacting for investors. For cash equities, we are supportive of extending interoperability arrangements across all major European CCPs to deliver true user choice and competition for services.

TRADING

It should be emphasised that the fixed income (FI) market operates under a different structure compared to equity markets, primarily trading on an OTC or electronic RFQ basis with liquidity provided by dedicated market makers, rather than anonymous CLOB models that are prevalent in the equities market, making some themes in this consultation (such as the connectivity between liquidity pools) less relevant to FI.

Broadly, the current wholesale equity trading market structure in Europe is competitive and resilient - leading to a range of liquidity pools across various mechanisms with intermediaries playing a crucial role in providing connectivity. This also applies to the retail segment where individuals are able to access capital markets either directly or via an extended network of intermediaries. The diverse array of trade execution mechanisms in the equity market, including continuous lit trading, auctions, and systematic internalisers (SIs), must be preserved. This diversity further supports the effectiveness of best execution rules for both institutional and retail investors.

Equity trading by trading mechanism (% total)



Source: BigXYT. Adjusted to exclude non addressable and non-price forming trades



As data shows, lit order book activity remains the largest portion of market activity, with the growth of alternative execution mechanisms is reflective of the execution needs of a diverse and global set of investors. These alternatives, such as SIs or periodic auctions, typically provide a slower execution time but a lower price impact – an important consideration for many investors. The immediacy provided by lit trading means that volumes typically spike during periods of market stress.

This diversity of trading mechanisms is observed in other jurisdictions such as the US. Although direct comparisons are difficult to make, BMLL and FINRA data estimates that approximately 45% of activity in US equity markets takes place off exchange. Compared to Europe, lit auctions represent a lower proportion of volumes. We consider that any perceived decline of continuous lit trading as a proportion of overall activity is primarily driven by the growing importance of the closing auction, rather than a rise in OTC or SI activity.

Access to markets should be made more cost effective for all investors, and policymaker focus should therefore remain on addressing barriers to entry such as the market failure in market data being available on a reasonable commercial basis, or the inefficiencies in the post-trade space described above, which add unnecessary frictional costs to all market participants.

The abovementioned barriers to entry can also help explain the limited participation of retail investors in European capital markets compared to other jurisdictions, notably the US.

RECOMMENDATIONS

Prioritise investors – improve their access to equity markets and ensure better outcomes.

- Improve the quality of information available to equity investors through delivery of a consolidated tape, providing all users with the clearest possible picture of available liquidity at the lowest possible price. Democratise market data by making the necessary regulatory changes to the ‘Reasonable Commercial Basis’ provisions.
- Assess whether models which direct retail equities flow towards a single market-maker or venue are aligned with current best execution principles and take appropriate enforcement action.
- In the broader context, promote measures that will generate increased investor demand for EU securities – for example through financial literacy programmes and the creation of attractive and easy-to-access investment vehicles.
- Direct retail investor participation should be carefully nurtured, whilst indirect participation of pensioners and savers, who entrust their money to asset and portfolio managers should not be less favourably treated. Trading modalities and features that cater for each group’s needs should be readily available and treated on an equal, neutral basis.
- Address national-level differences that create barriers to investing cross-border – e.g. withholding tax regimes. Focus on creating post-trade efficiencies to reduce what is currently a significant component of overall transaction costs.

Streamline EU regulatory framework – make EU markets easier to navigate without compromising on safety and investor protection.

- Enhance the application of the principle of proportionality – the EU financial services regulatory framework has evolved into a very complex set of rules, often lacking coherence. Policymakers should urgently prioritise the need for greater proportionality and consistency to ensure that any additional burden on market participants is duly justified and necessary in respect of the key policy objectives being pursued. This should be supported by robust impact assessment based on thorough data analysis and early and transparent engagement with stakeholders.
- Remove volume cap for equities – the EU is a global outlier in applying a volume-based constraint on equities ‘dark’ trading, which restricts investor choice and adds significant operational cost and complexity. Other jurisdictions which have removed volume caps, such as the UK, observe no material change in levels of dark trading post-removal.
- Remove the Share Trading Obligation – the STO limits the ability of investment firms to execute trades on the optimal trading mechanism for their clients. Other MiFID requirements are effective in directing activity towards platforms providing market transparency (including RMs, MTFs and SIs) without the need for the STO.
- There is scope for simplification of the current regulatory reporting framework which has been established in piecemeal fashion. The Commission’s renewed focus on burden reduction, including in the context of SIU, creates an opportunity to review areas where the regulatory burden on market participants could be alleviated without compromising the oversight role performed by regulatory bodies through regulatory reporting data.
- Retain existing flexibility for market participants to use omnibus accounts and settlement internalisation – these tools create substantial efficiencies and help reduce overall costs. Do not introduce more burdensome reporting requirements on settlement internalisers.
- Although AFME has not responded to Section 5, aimed at asset managers, we support targeted measures that will help maintain the attractiveness of UCITS as an investment vehicle. Article 56(2)b of the UCITS Directive should be amended, acknowledging the original intention of the 10% issuer limit - drafted prior to inception of the EU securitisation market - to prevent UCITS funds from acquiring shares that give the fund significant influence over strategic direction of the corporate borrower. The unintended consequence of application of this irrelevant limit is to constrain the manager by capping on average its exposure to a securitisation issuer to 5% of the exposure of a similarly rated corporate issuer.

Facilitate competition across the whole lifecycle - address areas where a current lack of user choice leads to excess costs and inefficiencies.

- Market users are mandated to use CSDs for the provision of key services, therefore pricing needs to be monitored to ensure that it is fair and transparent. At a minimum, greater transparency, and uniformity of CSD fees should be addressed through regulation.
- Mandate full interoperability between all CCPs. Current interoperability arrangements have been demonstrably successful in reducing costs for central clearing of cash equities transactions. Other models, such as so-called ‘preferred clearing’ restrict user choice and are not aligned with the spirit of open access provisions.
- Strengthen existing open access provisions to avoid “vertical silo” models within FMI groups. Ensure that the place of listing or trading does not constrain user choice on place of clearing or settlement.
- Address rising market data costs. Accessible market data is a critical component of healthy and well-functioning capital markets, empowering all market participants to make informed decisions when allocating capital. Existing provisions to ensure that providers make market data available on a ‘reasonable

commercial basis' have not been successful in controlling the spiralling cost of data, and further regulatory intervention is needed as a priority.

Promote industry-driven “functional harmonisation” of market infrastructure – moving closer to a single European operating model.

- Build on existing industry collaborative initiatives (e.g. the EU T+1 Committee) to explore opportunities for greater harmonisation of market infrastructure processes and timings, including trading venue and CSD operating hours and the provision of key functionalities such as partial settlement.
- Remove barriers to more integration of platforms and services within FMI groups.
- For corporate events, formalise the responsibility of the Issuer CSD to ensure timely, accurate and complete information is provided in a standardised format, as part of a targeted review of the Shareholder Rights Directive.
- Identify opportunities to grow T2S to cover additional markets and currencies.

Continue fostering innovation with new types of post-trade model

- Leverage the DLT Pilot Regime to create the possibility of distributed CSD functions (with new market entrants able to compete with incumbents for the provision of specific services).
- Take steps to improve the DLT Pilot Regime to maximise its flexibility and ensure that it remains competitive and attractive. This should include removing the thresholds and expanding the eligibility of participants.
- Make DLT-based assets eligible for use as collateral in central bank operations.
- Explore the possibility of a common issuance (notary/registration) service across EU CSDs, potentially leveraging T2S, to create a level-playing field and true competition for the provision of other CSD services.

Modernise the regulatory and supervisory ecosystem

- Elevating supervisory powers to the EU level is the direction of travel. It must effectively contribute to reducing cross-border frictions and acts as an enabling factor for the consistent application of the single rulebook.
- Upgrade ESAs' governance for a more independent decision-making process equipped with the appropriate expertise to ensure that the overall EU interest prevails.
- Enhance the effectiveness of the ESAs' forbearance powers and incorporate the objective of competitiveness in their mandate as a secondary objective to their regulatory function.

Simplify the EU rule making procedure

- Conduct an in-depth reflection to assess how the Lamfalussy process is functioning in view of the EU putting in place a more agile and effective regulatory and supervisory approach for globally competitive banking and capital markets.