"Capital Markets Union"

Commissioner Hill has often stated that stronger and deeper capital markets are vital for the creation of jobs and growth[1]. Europe needs to finance investment, create jobs and wealth, and boost economic growth. The European Commission estimates the overall investment needs for transport, energy and telecom infrastructures networks of EU importance to amount to 1 trillion EUR for the period up to 2020[2]. About 6 million European jobs have been lost because of the financial crisis[3]. While much progress has been made since the peak of the financial crisis, we are far from being on a path of continuous growth and the Commission has stated that fostering innovation is one of the best opportunities for growth and employment in Europe. The Commission recognises that Europe's economic development needs to be supported by more diversified funding sources and especially by a greater share of financing from capital markets. The urgency of developing market-based financing has been recognised at the highest political levels in Europe, including by the European Commission President in his Political Guidelines for the current European Commission[4] and in the CMU Green Paper[5].

But how can we meet these challenges? What should be the level of ambition of the CMU? How can we ensure that the CMU helps to finance the real economy in all EU Member States? What will companies and investors need? How can we develop markets without sacrificing stability and safety? Above all: Do we need a re-orientation or just a tweaking of policies?

[1] http://europa.eu/rapid/press-release_SPEECH-15-5624_en.htm

[2] European Commission Communication on Long-term financing of the European economy, 27 March 2014. http://ec.europa.eu/internal_market/finances/docs/financing-growth/long-term/140327-communication_en.pdf, page 2.

[3] http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=lfsi_emp_a&lang=en

[4] http://ec.europa.eu/about/juncker-commission/docs/pg_en.pd

[5] GREEN PAPER Building a Capital Markets Union {SWD(2015) 13 final}
http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=COM:2015:63:FIN&from=EN

Key Elements of a Capital Markets Union Action Plan

The European Commission is aiming to put in place the building blocks of a fully functioning, well-regulated Capital Markets Union (CMU) by 2019 as a top priority. While the European Fund for Strategic Investments (EFSI) will address the investment gap in the EU in the short and medium term, the CMU should aim to set the right framework for more and better diversified (and cross-border) finance in the European Union.

Help companies at all stages of the 'funding escalator' access market-based funding sources

The Commission has stated that EU companies mostly rely on bank funding to finance their growth. Although bank lending will remain a primary source of financing, recently changed regulatory requirements impact banks' capacity to lend. A diversification of funding sources towards a more equities funding/risk sharing culture will support high-growth companies to grow faster and will contribute to an increased shock absorption capacity by EU companies and by the overall economy. Therefore, the Commission is placing great expectations on the CMU to promote diversification of funding channels for companies.. Alternative investment funds such as venture capital and private equity funds can provide reliable sources of funding for high-growth firms, many of whom struggle to meet all their financing needs through bank loans. Moreover, support by the EFSI, and the European Investment Fund (EIF) will increase investments in venture capital funds. The Commission has recognised that key financial information on SMEs is usually limited and not readily accessible in forms that allow potential new investors/lenders to analyse or compare company performance. As a result SMEs struggle to reach the broader non-bank investor base that might suit their funding needs.

The Commission aims to lower the barriers to SMEs accessing capital markets by improving the availability of financial information on SMEs taking into account existing national systems as the basis for a European SME financial information system (as for example, sufficient level of information and a high degree of liquidity in secondary markets).

The CMU is also an important initiative to help companies use capital markets to meet their funding needs – for example, through revisions to the Prospectus Directive to make it easier to issue on public markets, or by looking into European corporate bond markets to make sure that the market supports the needs of issuers and investors.

Need for appropriate conditions for raising funds via capital markets

The Commission is also considering how to balance the cross-over between private capital-raising and public markets. Companies can benefit from the possibility to access capital markets through private placements. In general, private placement markets in Europe are underdeveloped compared to the US which may point to the need for greater standardisation of key documents. The Commission aims to examine how EU frameworks and practices apply in the context of private placements and contemplates safe harbours.

Although, European public equity and debt markets have developed significantly in recent decades, they still lag behind other developed economies. Moreover, the picture is very heterogeneous across EU Member States. The EU IPO Task Force report produced an estimation of issuing costs and stated that reducing these costs would incentivise companies to raise capital on public markets[6]. The main gateway to public capital markets is the prospectus which is a document that is required from companies that wish to offer shares or bonds 'publicly'.

Commission has committed itself to a revision of the Prospectus Directive and the main objective of this will be to reduce current administrative burdens linked to the prospectus in order to facilitate access to capital markets, both for SMEs and for larger firms who are more frequent issuers.

Increase investment flows to sustainable infrastructure projects

It is understood that pension funds and insurance companies are natural long-term debt and equity investors given their long-term liabilities.

[6] EU IPO Report issued by the European IPO Task Force (European Issuers, EVCA and FESE), 23 March 2015.

The new Solvency II regime, which will apply from January 2016, already includes various measures which aim to limit disincentives for long-term investments, but the Commission has stated that amendments to Solvency II with respect to European Long Term Investment Funds (ELTIFs) and infrastructure investments (including those benefiting from the EFSI) could further help the attractiveness of these assets for insurers. The Commission has committed itself to adopt a package of measures to boost infrastructure and long term investment by reviewing the Capital Requirements Regulation (CRR) and adjusting Solvency II. The Commission will facilitate the creation of dedicated funds, leveraging EFSI and other EU budget sources for infrastructure investment, in particular for innovative projects. Based on the expected impact of ELTIFs for the success of the CMU it should be taken into consideration that ELTIFs` framework could need further calibration to provide the ground for substantial investment volumes.

Promote investment opportunities for all retail and institutional investors

Much of Europe's household savings currently are in bank deposits. For the CMU to truly 'unlock' new sources of funding, the most important way will be to ensure that more savings are channelled safely and effectively to the real economy via capital markets – this will both put capital to use by directly investing in companies and projects and deliver a more meaningful economic return for the saver. Providing more opportunities for investors and savers begins with ensuring that savers have the means to save effectively via either pensions or insurance products – or directly into capital markets in shares, bonds, or through investment funds. In this regard, it is important to encourage more long term and scaled up investment into equities as a trigger to more sustainable and responsible capital markets. Retail investors have been steadily reducing their investments in company shares and other capital market investments in recent decades.

There have been significant efforts to strengthen financial legislation to improve investor protection standards, in particular through enhanced disclosure and transparency requirements for some investment products, which will come into force in the coming years.

The Commission recognises the need to reinforce transparency, cross-border competition in financial services, standardisation for retail investors and find ways to enhance the distribution of investment products, especially when it comes to providing investment advice.

The CMU Action Plan also envisages the possibility of introducing a pan European personal pension product as a way to support longer-term/retirement related savings and strengthen the single market in personal pension provision.

For institutional investors, the Commission identified as a possible barrier to cross-border investment, the discriminatory taxation of pension funds and life insurance companies. Pooled investment funds, where savers combine their savings with those of others in order to increase investment opportunities, are regulated at EU level through two directives, the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive for retail mutual funds and the Alternative Investment Fund Manager (AIFM) Directive for non-UCITS funds, the latter being due for revision in 2017. The Commission will, by working with ESMA, step up efforts to remove persistent obstacles to cross-border marketing of investment funds: eliminating cross border fees and requirements will enhance the competitiveness of products, accentuate competition and support consolidation of the retail fund sector.

Use capital markets to enhance the capacity of banks to lend

A well-functioning securitisation market can allow capital markets to help banks to free up capital for additional lending. In contrast to many US-originated securitisations that contained poor quality assets or relied on complex structures, European securitisation transactions have performed well throughout the crisis, but have been unfairly stigmatised by poor performance and practices in US markets. The objective of the securitisation initiative is to revive the EU securitisation market through the identification of Simple, Transparent, and Standardised (STS) transactions benefitting from a preferential capital treatment, in the relevant banking and insurance legislation. In this context it seems reasonable, like scheduled by the Commission, to review the adequacy of risk-weightings in Solvency II and CRR when it comes to STS transactions.

Under the Investment Plan, the EIF and national promotional banks are also supporting securitisation transactions, notably of SMEs. The Commission has proposed legislation to revitalise European STS securitisations and consult on how and if to build a pan European covered bond framework to consolidate the sound function of this important source of funding for European banks and loans. Covered bonds are debt obligations that are issued by banks and secured by other assets, such as mortgages. While EU banking legislation provides a favourable prudential treatment of some covered bonds, the legal framework under which they are constituted is national. Well-functioning national covered bond regimes must be preserved.

Horizontal barriers to cross-border investing

The Commission believes that the CMU is about the free flow of capital across borders. For businesses and citizens to reap the benefits of a truly single market for capital ultimately requires action to improve the general framework on which capital markets rely. Currently, there are a number of national rules restricting cross-border capital movements and the Commission is seeking to give stronger effect to Treaty provisions on the free movement of capital. The Commission aims to engage with Member States to identify and remove national barriers to free movement of capital which reduces the attractiveness of those countries as investment destinations, and deny access to investment opportunities to pan-European investors.

Furthermore, well-designed insolvency and restructuring rules are important throughout the lifetime of a business, and are particularly relevant in the aftermath of the financial crisis. Good, minimal harmonised standards applied throughout the Union would provide more clarity for cross-border investment decisions, including for investors from outside Europe, facilitate deleveraging and encourage fresh starts. Against that backdrop, the Commission issued a Recommendation in 2014 on a new approach to business failure and insolvency, focused on early stage restructuring and second chances. This Recommendation promoted common outcomes but was non-binding.

Differences in tax regimes across Member States can also impede the development of a single market for capital as they create obstacles to cross-border investments and fragment markets. The Commission can work with Member States to identify the largest barriers, issue best practice guidelines and propose a simplified and unified template for the recovery of the withholding tax. Differences in tax treatment of different types of funding may create distortions to efficient capital market financing. Equities financing should benefit from similar tax allowances as debt financing, and levelling the playing field to foster optimal capital allocation.

EU regulatory framework for financial services

In tandem with the publication of the Commission's Action Plan, they have also launched a consultation[7] that is looking for empirical evidence and concrete feedback on:

- rules affecting the ability of the economy to finance itself and growth (e.g. FTT);
- unnecessary regulatory burdens;
- interactions, inconsistencies and gaps;
- rules giving rise to unintended consequences.

The Commission is committed to fully implement its current regulatory program in order to achieve financial stability for the creation of jobs and growth but is canvassing to identify potential inconsistencies and gaps.

Conclusion

It must be understood that legislation will not always be the right instrument for all these initiatives, and in keeping with the Better Regulation agenda, non-legislative actions should also be considered especially where best market practices have developed. The Commission has stated that for each initiative, the CMU Action Plan will be accompanied by an implementation plan which defines the intermediate steps/milestones, inputs and resources needed to support delivery. As stated by Commissioner Hill, the Commission aims to promote more single market, more free trade, more structural reform, a stronger economic and monetary union, more competition, more investment and more capital markets. They envisage a bigger role for capital markets in the European economy for growth, increasing funding options, giving retail investors more opportunities, and making the economy more resilient.

[7] http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Secretariat or the Chair of the Financial Industry Committee.

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