Capital markets union
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The new European Commission has identified the Capital Markets Union (CMU) as a flagship initiative for its five-year mandate.

Since 2008, bank lending in Europe has fallen by 10%. Capital market lending has filled that gap, but only just.

The previous Commission focused on the necessary reform of the system for financial regulation, in Europe and globally. Promoting growth was, understandably, not always the top priority.

CMU could help address the issue of a lack of sufficient long-term finance as Europe faces a growth crisis.

Comparing the development of EU and U.S. capital markets shows that U.S. capital markets are bigger, more diverse and more resilient.
AFME’s positioning

• The financial sector can and must play a central role in creating growth through a successful capital markets union.

• AFME is committed to supporting the Commission’s initiative on building a capital markets union.

• CMU process should promote growth and investment. The process should examine legislative and regulatory issues, market impediments and business practices in order to identify the key steps forward.

• We propose that the work programme for CMU is organised under three complementary pillars, covering:
  ➢ issuance of capital market funding (the supply side);
  ➢ long-term investment (the demand side); and
  ➢ market infrastructure for capital markets issuance and trading.
Goals for a capital markets union
The economic case for CMU is based on:

- creating larger and more efficient capital markets;
- strengthening financial resilience in Europe; and
- supporting transmission of monetary policy

A single financial market is a longstanding goal for Europe. Key milestones were the Single Market Programme (1985) and the Financial Services Action Plan (1999)

General acceptance that the approach of promoting EU integration and growth through legislation has hit diminishing returns

The Commission needs to consider what kind of CMU should be built and how far the EU is from achieving that vision – taking into account the legislation that is already in place
• Since the 1970s, the EU has adopted a number of legislative measures which have, directly or indirectly, helped to promote a CMU.

• Key takeaways on the EU legislative base are that:
  
  ➢ liberalisation is a longstanding goal of EU policy in banking and insurance;
  ➢ extensive EU legislation on company law, accounting, audit and credit ratings;
  ➢ initiatives in securities and investment occurred later – and the focus of EU securities legislation is on listing, prospectus requirements and market abuse;
  ➢ with the advent of the Single Market Act the EU made major reforms to liberalise capital movements and remove barriers to establishment;
  ➢ the broad ‘rulebook’ approach pursued in MiFID, EMIR and AIFMD is relatively new – as is the use of EU regulations rather than directives; and
  ➢ the development of a pan-European component to supervision has been recent and fairly gradual, with the first steps taken following the Lamfalussy report.

• We would encourage the Commission to look at the existing statutes to see what has worked well, and what has not
The economic base for CMU

• The EU could define its ambitions for a CMU by reference to the most developed and larger marketplaces in advance economies

• Comparison of EU and U.S. capital markets shows that:
  ➢ around 25% of debt funding in Europe is provided by the capital markets, compared to around 80% in the US;
  ➢ the overwhelming majority of SME funding in Europe is provided by the banking system, unlike the U.S.; and
  ➢ the stock of listed equity in the US is around 120% of GDP in the U.S., compared to c.75% in Europe

• How much of the gap to the U.S. can be closed? Some basic structural differences will always remain – e.g. language, taxation, govt policy
An outcomes-focused project

• We will encourage the Commission to consider setting hard targets to define a clear economic ambition for CMU, e.g.
  ➢ increasing the capital markets’ share of debt financing;
  ➢ increase Europe’s stock market capitalisation;
  ➢ growing the share of capital market funding to SMEs; and
  ➢ Targets for issuance of specific instruments.

• There should be a strategic approach to policy development – with a very small number of new regulatory proposals, designed to deliver the maximum economic impetus to CMU

• On each issue where action is required, there should be detailed analysis of the appropriate form of intervention, e.g.:
  ➢ industry-led initiatives;
  ➢ review of existing EU regulation;
  ➢ action by Member States and regulators; and
  ➢ new EU legislation.
Three pillars of capital markets union
Three pillars of capital markets union

• To achieve the targets put forward, AFME proposes that the work programme for CMU is organised under three pillars with complementary objectives:
  
  ➢ **Issuance** – developing more efficient and liquid markets for issuance of financial instruments;
  ➢ **Investment** – harnessing long-term savings to promote investment;
  ➢ **Infrastructure** – promoting open, integrated market infrastructure.

• The end-user perspective must be embedded in all CMU initiatives – the goals are lower costs, greater choice, and market confidence

• For each objective we propose a limited number of high impact interventions, as follows
Three pillars of capital markets union

1. Issuance of capital market instruments (the supply side)

   • Fixed income:
     - Harmonise securitisation regulation both within Europe and with respect to third countries;
     - Facilitating the development of a European market for private placements and high yield;
     - Enhancing the European infrastructure funding market;
     - Harmonising the regimes for covered bonds.

   • Equity:
     - Advancing a pan-European takeover code;
     - Reviewing the level of disclosure for IPOs in the context of the listing and ongoing reporting regime for corporates for both regular and growth listings;
     - Consider targeted tax deductions for small business equity;
     - Consider the impact of withholding taxes on cross-border dividend payments.
2. Investment in the capital markets (the demand side)

- **Greater product choice for investors**: safe harbour regimes and a product regime for investment in loans;

- **Achieving greater harmonisation of EU insolvency rules**: differences between national insolvency frameworks can discourage the timely restructuring of viable companies in financial difficulties and often lead to liquidation rather than providing the ability to restructure as an ongoing concern;

- **Appropriate calibration of the capital framework for institutional investors**: aspects of the current EU prudential framework for insurers and pension funds are discouraging certain types of productive long-term investment in Europe’s capital markets;

- **Maintaining a viable model for capital markets research**, which is of particular concern to SMEs raising equity.
Three pillars of capital markets union

3. Infrastructure for capital markets issuance and trading

- **Clearing and settlement: integration of infrastructures:** differences in clearing and settlement procedures between markets are the cause of material inefficiency and cost;

- **Securities law to clarify collateral ownership:** develop EU legislation to clarify ownership of securities when trading cross-border;

- **Removal of barriers to cross-border collateral use:**
  - ensuring that there can be free flow of collateral and collateral availability across entities and across borders;
  - ensuring that this is not constrained by excessive regulatory restrictions (e.g. caused by constraints on the repo markets, margin requirements, insolvency laws etc); and
  - standardising forms of collateral (e.g. assets and transactions) where appropriate.

- **Ensure broad and affordable access to real-time market data:** delivering a single European Consolidated Tape to improve the quality and consistency of post-trade data
**Initial AFME proposals to promote CMU**

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<thead>
<tr>
<th>Industry action</th>
<th>Issuance</th>
<th>Investment</th>
<th>Market infrastructure</th>
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<tbody>
<tr>
<td><strong>Private placement</strong></td>
<td>develop standard documents and practices to promote pan-EU market</td>
<td>Engagement in review of proposed European Long Term Investment Funds, as a possible new legal and regulatory instrument to support investment in illiquid assets.</td>
<td>support implementation of ECB T2S platform, assisting with broader EU harmonisation</td>
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<td><strong>High yield</strong></td>
<td>develop simpler, more uniform disclosure across European industry</td>
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<tr>
<td><strong>Securitisation</strong></td>
<td>initiatives to promote securitisation market, with a focus on SME loans</td>
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<table>
<thead>
<tr>
<th>Review existing EU measures</th>
<th>Issuance</th>
<th>Investment</th>
<th>Market infrastructure</th>
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<tbody>
<tr>
<td><strong>Securitisation</strong></td>
<td>streamline reporting requirements</td>
<td>Recast MiFID proposal in order to maintain research coverage of EU firms, particularly midcaps and SMEs</td>
<td>ensure flow of collateral is not constrained by excessive restrictions (e.g. on repo markets, margin requirements, insolvency laws.)</td>
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<td><strong>M&amp;A</strong></td>
<td>review Takeovers Directive to reduce obstacles to capital flows</td>
<td>Recalibrate prudential capital rules for investors (notably in Solvency II) and for bank investment; harmonise risk retention rules</td>
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<tr>
<td><strong>Equities</strong></td>
<td>review SME regime in Prospectus Directive; reduce research blackout periods</td>
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<th>Action by governments or regulators</th>
<th>Issuance</th>
<th>Investment</th>
<th>Market infrastructure</th>
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<tr>
<td><strong>Equities</strong></td>
<td>review tax treatment of SME equity; review withholding taxes on cross-border equity</td>
<td>Review tax treatment of SME equity; review withholding taxes on cross-border equity</td>
<td>open, affordable access to data from primary exchanges; development of a European Consolidated Tape for post-trade data</td>
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<tr>
<td><strong>Securitisation</strong></td>
<td>embed and recognize a core definition of high quality securitisation</td>
<td>Identify incentives for brokers and research providers to widen coverage of SMEs and midcap firms</td>
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<td><strong>Project finance</strong></td>
<td>greater public sector commitment on tariffs, regulatory regime and project pipelines</td>
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<th>New EU legislation</th>
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<td><strong>Safe harbour regime</strong></td>
<td>develop an EU-wide regime to promote development of key funding markets (e.g. private placement)</td>
<td>Develop an EU-wide regime to promote development of key funding markets (e.g. private placement, loan funds)</td>
<td>Securities Law Directive to provide certainty of cross-border share and collateral ownership</td>
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<td><strong>Insolvency reform</strong></td>
<td>examine scope for greater harmonisation of insolvency rules in Europe</td>
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Institutional framework for capital markets union
Overall, we consider that while important improvements in the functioning of the current framework can be achieved, the current institutional framework for securities markets supervision in Europe is broadly fit-for-purpose

- **Single Market:**
  - CMU is fundamentally a single market concept and requires the achievement of two key freedoms: free movement of capital and services;
  - Principle of subsidiarity applies

- **Banking Union:**
  - CMU involves different needs from Banking Union. Focus should be on building a single rulebook and close convergence of supervisory practices, rather than a single supervisory authority
Supervisory convergence and the role of ESMA

It would be important to strengthen and enhance the existing securities supervision in Europe. In this context the European Supervisory Authorities (ESAs), including ESMA, should be strengthened:

• explore governance reforms aiming at greater independence and effectiveness (e.g. as regards the composition, role, tasks and powers of the Board of Supervisors and the Management Board);

• base the development of a single rulebook on the principles of clarity, efficiency, openness, transparency and evaluation;

• consider the funding arrangements for ESAs.
We believe that a guiding principle for future CMU initiatives – and the overall CMU framework – should be promoting open and attractive EU markets while maintaining appropriate levels of investor protection and a level playing field between EU and international players.

We would emphasise the following priorities:

- Developing a consistent approach to third country equivalence across different EU legislations;
- Strengthening the framework for global regulatory coordination;
- reducing the reliance of public and private sector issuers on local funding markets.

The rewards for delivering CMU will be substantial: deeper, more diverse capital markets; a more stable financial system; and above all, new business, new jobs and new investment in Europe.
The Association for Financial Markets in Europe advocates stable, competitive and sustainable European financial markets that support economic growth and benefit society.

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