
High-Level Forum on Capital Markets Union

AFME Feedback to HLF Sub-Groups on Interim Report & Recommendations

March 2020

Introduction

The Association for Financial Markets in Europe (AFME) has been a strong supporter of the Capital Markets Union (CMU) project since its early stages. The importance of the CMU has been well articulated in the Interim Report of the High-Level Forum (HLF) and other contributions. We can only strongly concur with the conclusion in the Interim Report that the CMU is “a structural reform that Europe needs in times of great transformation. The Capital Markets Union can deliver on its promises only with strong and immediate political support at the highest level, as well as coordination among all the European institutions to push bold reforms forward”.

In this submission we aim to provide feedback on concrete recommendations and specific legislative and regulatory actions to deliver on the CMU objectives and identified priorities.

We group our recommendations according to four themes in the summary table listed below, following the headings and ordering found in the Interim Report; a description of the priorities and specific legislative recommendations is included further below.

1. Financing for business, with a focus on SMEs
2. Market structure, infrastructures and market access
3. Retail and institutional investment
4. Cross-cutting issues, including legal frameworks

In the table below, “high priorities” are measures which we believe have a high transformative potential and are most pressing to advance the CMU. “Medium priorities” may also have strong potential but we see less urgency in pursuing them at this stage compared to the high priorities.

In considering measures on the future of CMU, we also encourage the High-Level Forum to take into consideration **the role of banks in European capital markets and the impact of prudential regulation on banks’ capital markets activities**. Banks play a central role in capital markets by, for example, helping companies and governments to raise finance in primary markets and providing liquidity in secondary markets. They also help corporates, pension and investment funds and other banks manage their risks. It is therefore important that the prudential framework, which will undergo further changes as the December 2017 Basel agreement is implemented in the EU, is correctly calibrated to ensure that banks can continue to support activities such as **market making** which are fundamental to the functioning of capital markets and therefore the development of the CMU.

AFME recommendations on measures and regulatory actions for Capital Markets Union 2.0

Topic	Prioritisation, proposed completion date and responsibility
Financing for businesses, including SMEs – strengthening public equity markets	
1.1 – Improving and converging key regulatory standards in the IPOs process, to reduce the cost and execution risk of IPOs and widen the pool of interested investors	Priority: High Completion: 2024 Responsibility: EU level
1.2 – Providing tax incentives to foster investment in equity for SME Growth markets	Priority: High Completion: 2024; see also action 3.2 which is complementary. Responsibility: National level
1.3 – Creating a central EU filing system for offering company information and documentation (an EU “EDGAR”), to improve data access and transparency	Priority: Medium Completion: 2024 Responsibility: EU and national levels
Market structure, infrastructures and market access Improving efficiency and connectivity in trading and post-trading	
2.1 – Recalibrating the MiFID 2/R framework, to support more efficient and better-connected securities markets	Priority: High Completion: 2020-22 (potential consideration under MiFID 2/R review) Responsibility: EU level
2.2 – Reviewing the CSDR settlement discipline regime in order to remove the mandatory obligation on investors to execute buy-ins, while preserving investor choice, in order to avoid illiquidity	Priority: High Completion: The removal of the mandatory buy in obligation should be undertaken as soon as practicable and before February 2021. Responsibility: EU level
2.3 – Ensuring open access to market infrastructure, to maximise competition and efficiency in trading and post-trading services	Priority: High Completion: Open access conditions for CCPs and trading venues are expected to apply from July 2020; ongoing monitoring of the faithful implementation of these conditions is important.

	Responsibility: Commission, relevant NCAs
2.4 – Facilitating the ability of CSDs to provide services on a cross-border basis, and tackling barriers in the CSDR that restrict the provision of such services	Priority: Medium Completion: 2024 Responsibility: EU level
2.5 – Building a consolidated tape for equity markets, to improve pan-European investor transparency of current market activity	Priority: Medium Completion: ESMA has estimated that it would take at least five years from the decision to establish a consolidated tape until go-live. Responsibility: EU level, ESMA
Retail and institutional investment – increasing pools of investible capital	
3.1 – Introducing auto-enrolment into employee pensions, to significantly grow the pool of capital available for investment	Priority: High Completion: This action may require work at the EU and national levels over a longer period. We recommend the issuance of a Commission Recommendation or other instrument setting out a realistic timeline, with progress assessed on a yearly basis and a stocktake by the end of the policy cycle in 2024. Responsibility: National level; Commission recommendation
3.2 – Developing tax-efficient investment savings accounts for private individual investors, to significantly grow the pool of capital available for investment	Priority: High Completion: This action may require work at the EU and national levels over a longer period. We recommend the issuance of a Commission Recommendation or other instrument setting out a realistic timeline, with progress assessed on a yearly basis and a stocktake by the end of the policy cycle in 2024. Responsibility: National level; Commission recommendation
3.3 – Improving the ELTIFs framework, to widen the pool of investors eligible to invest in project finance	Priority: Medium Completion: 2024 Responsibility: EU level

Cross-cutting issues, including legal frameworks – establishing fundamental market functioning mechanisms	
4.1 – Reviewing the EU securitisation regulatory framework, to improve the functioning of this mechanism vital to Europe’s capital markets	Priority: High Completion: 2022 (as soon as practicable) Responsibility: EU level (various actions needed)
4.2 – Addressing tax-related obstacles to cross-border investment, including withholding tax, to deepen single market integration and cross-border investment	Priority: High Completion: 2024 Responsibility: EU and national levels
4.3 – Harmonising EU-wide definitions of key concepts in financial markets (e.g. financial instrument or legal owner of a security) and standardising rules and operational practices in post-trading, including corporate actions processing, to deepen integration and achieve legal and operational consistency	Priority: High Completion: 2024 Responsibility: EU level
4.4 – Improving and converging insolvency laws, to encourage all sizes of corporates to restructure their businesses more quickly with more consistency, to increase overall risk capital investment interest in EU businesses	Priority: High Completion: This workstream will require work over a longer period. We recommend establishing a roadmap with ambitious but realistic deliverables to be completed by 2024, with work to continue in the next political cycle. Responsibility: EU and national levels
4.5 – Working towards European safe asset instruments, to support financial stability and broaden market liquidity	Priority: High Completion: This workstream will require work over a longer period. We recommend establishing a working group composed of public authorities and market participants to conduct research and produce a report with analysis on the feasibility of different approaches and recommendations for consideration. Responsibility: EU level

1 Financing for businesses, including SMEs

The EU needs more equity capital to generate economic growth and employment. Equity risk capital is particularly suitable for early-stage enterprises with a limited or no track record but above-average growth prospects. Established companies also benefit from equity capital for example to expand into new markets or build new production sites, or to start a new business with uncertain outcomes.

1.1 Improving and converging key regulatory standards in the IPOs process, to reduce the cost and execution risk of IPOs and widen the pool of interested investors

Public equity markets play a critical role in providing companies access to long term risk capital to support innovation and growth. Given the importance of equity in financing economic growth, we believe that improving the IPO process in Europe should be a priority.

We recommend consideration of the following measures:

- Harmonising and reducing free float¹ requirements, to allow a better comparison between venues based on the availability of investors and liquidity, rather than regulatory differences;
- Moving towards converging the liability regime across the EU for the marketing of offerings by issuers and investment banks and the rules governing the ability of issuers to incorporate information into a prospectus by reference. Examples of differences include: (1) different liability standards applying to the various disclosures required under the Transparency Directive, the Market Abuse Regulation, and the Prospectus Regulation; and (2) different liability regimes applying in member states, as described by ESMA².
- **Benefit:** Improving the IPO process and reducing the cost and execution risk of IPOs is important to promote public equity markets and particularly important with the recent increase in the number of IPOs withdrawn or postponed.
- **Priority:** High **Proposed completion:** 2024

1.2 Providing appropriate tax incentives to foster investment in equity for SME growth markets

The enterprise investment scheme (EIS) and venture capital trust (VCT) in the UK are examples of schemes to encourage investment in unlisted companies or companies listed in the Alternative Investment Market (AIM) in London, an SME growth market. Both the EIS and VCT schemes are designed to encourage savers to invest in unlisted or AIM-listed companies with the increased risks being compensated for by tax breaks. Both schemes offer tax reliefs if there are losses on the investment. Investments have to be held for a certain number of years.

The availability of specific tax incentives to investors as well as issuers appears to have had a strong positive effect in the growth of the AIM market in London. Please refer to Annex 1 below where we have provided an informal comparison of SME growth markets in Europe.

In order to foster greater investment in other European SME growth markets, investors could be encouraged by similar or new schemes to incentivise investment whilst providing relief if a company fails. AFME supports consideration of such initiatives at EU level and in member states.

¹ Free float represents the portion of shares of a corporation that are available to public investors.

² ESMA report, ESMA/2013/619, Comparison of liability regimes in Member States in relation to the Prospectus Directive.

Measures could be considered in conjunction with the development of tax efficient investment savings accounts as proposed under section 3.2 below.

- **Benefit:** AFME is of the view that appropriate tax reliefs as noted above could provide powerful incentives in support of the development of SME growth markets. The practices adopted in the AIM market could serve as a reference for consideration in member states.
- **Priority:** High **Proposed completion:** 2024

This area requires action at the national level. Please also refer to action 3.2 below which is complementary.

1.3 Creating a central EU filing system for offering company information and documentation, to improve data access and transparency

The idea of establishing an EU-wide EDGAR – comparable to the [US SEC EDGAR system](#) – has been under consideration for some time. Current arrangements such as the list of Officially Appointed Mechanisms mandated by the Transparency Directive do not achieve the same level of ambition. As the US SEC does with EDGAR, ESMA, or a contractor appointed by ESMA, could be given the role to directly collect company filings for listed and eventually unlisted companies with a standardised format and made easily accessible across Europe via a common repository. A first step could be to implement a European system with an opt in for companies that wish to disclose their information in English in a centralised system. Those that opt in could be discharged from publishing the information elsewhere or in another language.

- **Benefit:** An EU central electronic filing system could help to increase the efficiency and accessibility of corporate filings. Such a system would facilitate the flow of information about companies to potential investors and other participants and by permitting issuers to submit prospectuses to competent authorities online.
- **Priority:** Medium
- **Proposed completion:** 2024. A European EDGAR, or the minimum steps we propose, could be established by the end of the 2019-2024 EU policy cycle.

2 Market structure, infrastructures and market access

We support the High-Level Forum's analysis in the interim report on the need to enhance the integration and efficiency of trading and post-trading in the EU. The development of European capital markets is hampered by inefficient regulatory frameworks and differences in access requirements between market infrastructures and in their market practices, which result in market segmentation.

AFME believes that it is important to encourage competition and choice in the provision of secondary market services, and to achieve a high degree of harmonisation in access requirements and in market practice to the benefit of investors. Such harmonisation reduces complexity, and facilitates market access, for all market participants.

AFME suggests that the HLF makes proposals that:

- Improve secondary market efficiency and connectivity;
- Strengthen open access requirements;
- Strengthen the use of market standards;
- Develop interoperability.

2.1 Recalibrating the MiFID 2/R framework in support of more efficient and better-connected securities markets

The upcoming reviews of the MiFID 2/R framework should be pursued in alignment with the CMU objectives to strengthen the capacity of EU capital markets and enhance their efficiency and connectivity. Such a recalibration should be undertaken with a view to improving outcomes for investors. This will, in our view, require a focus on market structure efficiency, well-calibrated transparency regimes that support liquidity, market confidence and EU competitiveness; bearing in mind at all times the proportionality of the constraints and costs imposed versus the outcomes that are being sought.

AFME is supportive of the following measures in alignment with the above-mentioned objectives:

- Removal of inefficiencies in equities trading regulation, particularly the share trading obligation and the double volume caps, the effects of which have not been positive for Europe's markets;
- Establishing a more proportionate investor protection regime for the benefit of the end investor, including a better differentiation between professional and retail clients in key areas;
- Addressing the problem of high market data costs³;

AFME will be providing further feedback in its responses to the Commission and ESMA consultations on MiFID 2/R issues launched in 2020, which we will be pleased to share with the High-Level Forum.

- **Benefit:** The effectiveness of the market structure and conduct rulebook is vital to building well-regulated, efficient, liquid, competitive and attractive capital markets for investors and end-users. Our assessment is that MiFID 2/R has been very costly to implement for all segments of the financial sector and remains so on an ongoing basis and certain provisions in the above-mentioned areas should be recalibrated in alignment with the CMU objectives.

³ Market data costs have increased significantly since MiFID 2/R and data licences are complex for investment firms consuming this primary input. MiFID 2/R requires trading platforms to make pre and post-trade market data available on a "reasonable commercial basis". Notwithstanding this requirement, consumers of market data report significant price increases, most notably from the primary exchanges that lack the competition which typically drives down prices.

- **Priority:** High

Proposed completion: 2020-22

2.2 Reviewing the CSDR settlement discipline regime to remove the mandatory obligation on investors to execute buy-ins, while preserving investor choice, to avoid market illiquidity

The mandatory obligation on investors under certain circumstances to execute buy-ins restricts the ability of investors to manage their trading and settlement processes. This will negatively impact the efficiency of European capital markets, leading to greater costs and barriers to investing in European securities. Mandatory buy-ins are expected to lead to wider bid-offer spreads in the cash markets, reduce market efficiency and remove incentives to lend securities in the securities lending and repo markets.

In the review of the CSDR, the mandatory obligation for investors to execute buy-ins should be converted into an optional right to execute a buy-in.

- **Benefit:** Avoiding the severe negative effects noted above.
- **Priority:** High
- **Proposed completion:** The removal of the mandatory buy-in obligation should be undertaken as soon as practicable and before February 2021.

2.3 Ensuring open access to market infrastructures, to maximise competition and efficiency in trading and post-trading services

First recommended in 2001 by the 'Giovannini Group' as a crucial element of the single market in Financial Services, MIFID II /MIFIR established a harmonised EU regime for non-discriminatory ('Open') access between Central Counterparties (CCPs) and trading venues for exchange traded derivatives. The aim was to integrate EU markets, strengthen competition, spur innovation and lower costs. After the expiration of a transitional provision in July 2020, the Open Access regime will finally apply across Europe.

AFME's view is that existing provisions on open access should be implemented as foreseen in the legislation and monitored.

- **Benefit:** Fair and open access to trading and clearing infrastructure as mandated by the existing MiFID2/R rules is vital to maintaining integrated, safe, efficient and continuous markets. Open access leads to lower costs, deeper pools of liquidity, improved service levels, greater capital efficiency and innovation.
- **Priority:** High
- **Proposed completion:** Open access conditions for CCPs (central counterparties) and trading venues are expected to apply from July 2020; ongoing monitoring of the faithful implementation of these conditions is important.

2.4 Facilitating the ability of CSDs to provide services to issuers on a cross-border basis, and tackling the barriers in the CSDR that restrict the provision of such services

An important factor leading to the segmentation of national capital markets across Europe is the existence of nationally based issuer CSDs, coupled with differences and complexities in access requirements. One of

the objectives of CSDR was to achieve increased competition in the provision of services by issuer CSDs to issuers, and to encourage the development of issuer CSDs that can offer services to issuers from many countries. With respect to these objectives, CSDR has had very little effect, with very few CSDs currently being able to offer services to issuers on a cross-border basis.

One significant reason is the complexity and cost of the CSDR process for the authorisation of such services, as set out in Articles 23 and 49 of CSDR. This specific CSDR process is much more burdensome than the standard “passporting” process under most European legislation.

The review of CSDR should lead to measures to increase competition between CSDs. One specific measure should be to bring the CSDR “passporting” process into line with the approach taken by other pieces of European legislation.

- **Benefit:** Greater competition between CSDs, the emergence of multimarket CSDs or new entrants with innovative, cross-border business models would lead to increased integration and efficiency in Europe’s post-trading services architecture.
- **Priority:** Medium **Proposed completion:** 2024

2.5 Building a consolidated tape for equity markets, to improve pan-European investor transparency of current market activity

Access to data is indispensable for market participants to carry out their activities. Concerns about data quality, data availability and high fees can lead to less efficient pricing of securities, more volatile and less liquid markets, and an unlevel playing field among participants.

AFME members do not believe that a consolidated tape will be a solution to persistent problems regarding the high cost of market data, which we identify as a fundamental concern to be addressed in Europe’s securities markets. AFME has commented on the proposed solutions and approaches to tackle this area of concern⁴.

AFME does believe that an appropriately constructed consolidated tape for equity markets can help to build deeper and more open capital markets in Europe. A key aim should be to democratise access across European markets with the aim of providing all investors regardless of resources or sophistication with a comprehensive and standardised view of European trading. This infrastructure would benefit the wider European market.

The creation of a consolidated tape also provides an opportunity to address fundamental issues regarding data quality, particularly in relation to post-trade transparency. Providing solutions in this regard will be an important step in ensuring that market participants have an accurate view of trading volumes, how those volumes are distributed across different trading venues and how they have changed over time. Such work would also bring tangible benefits regarding the application of other existing provisions within MiFID 2/R.

- **Benefit:** Potential for democratising access to data across European markets, contributing to European integration and promoting retail investor participation. Opportunity to address known issues relating to data quality and existing challenges with MiFID 2/R.
- **Priority:** Medium

⁴ See AFME “Response to ESMA Consultation Paper – MiFID II/MiFIR review report on the development in prices for pre – and post trade data and on the consolidated tape for equity instruments”, September 2019.

- **Proposed completion:** ESMA has estimated that it would take at least five years from the decision of establishing a consolidated tape for equity markets until the go-live, acknowledging that establishing such a system would be a complex and long process.

3 Retail and institutional investment

The HLF Interim Report rightly identifies that a large part of the wealth of European households is placed in cash deposits with currently negative real returns, and that pension inadequacy is an important problem.

AFME supports this analysis and supports the development of pan-European personal pension products, but also believes that by themselves these products will not be “game-changers”. AFME believes that the HLF should consider two initiatives with great potential for the development of capital markets: automatic enrolment in workplace pension schemes and the development of investment savings accounts for private individual investors.

3.1 Introducing auto-enrolment into employee pensions, to significantly grow the pool of capital available for investment

Such schemes make it mandatory for employers to automatically to enrol their eligible employees into a pension scheme. Typically, employers must also pay money into the scheme.

- **Benefit:** Experience in some jurisdictions suggests that auto-enrolment can lead to very significant growth in pensions savings over a relatively short period of time, thereby increasing investment in capital markets⁵.
- **Priority:** High **Proposed completion:** Completion of this action may require work at EU and national level over a longer period given the interaction with national pension systems, national tax systems, national consumer protection arrangements and other arrangements. We recommend the issuance of a Commission Recommendation or other instrument setting out a realistic timeline for member states to take steps, with progress assessed on a yearly basis and a stocktake by the end of the policy cycle in 2024.

3.2 Developing tax-efficient investment savings accounts for private individual investors, to significantly grow the pool of capital available for investment

Tax-efficient investment savings accounts for private individual investors could be a strong channel for significantly expanding direct investment by private individuals in EU capital markets, a core objective of the CMU⁶.

- **Benefit:** The principal benefit of national systems to develop investment savings accounts is that they allow private individual investors to invest directly in capital market instruments in a manner that is administratively simple. Holdings on investment savings account may also, depending on national tax policy choices, benefit from tax advantages. Pension schemes and private individuals are long-term investors that contribute to capital market eco-systems, and that are particularly important for investment into SMEs. Private individual investors are highly sensitive to complexity and cost in tax and other administrative processes.

Priority: High **Proposed completion:** Completion of this action may require work at EU and national level over a longer period given the interaction with national pension

⁵ As noted in the Next CMU High-Level Group Report: “In the UK the introduction of auto-enrolment with an opt-out, starting from larger companies and low premiums, going to smaller companies and somewhat higher premiums, has achieved results in relatively limited time, demonstrating that a well-designed scheme of workplace pensions can take-up quicker than often assumed.”

⁶ An example is the individual savings account (ISA) which is a class of retail investment arrangement available in the UK. Payments into the account are made from after-tax income, then the account is exempt from income tax and capital gains tax on the investment returns, and no tax is payable on money withdrawn from the scheme. A broad range of investments can be held within the arrangement.

systems, national tax systems, national consumer protection arrangements and other arrangements. We recommend the issuance of a Commission Recommendation or other instrument setting out a realistic timeline for member states to take steps, with progress assessed on a yearly basis and a stocktake by the end of the policy cycle in 2024.

3.3 Improving the ELTIFs framework, to widen the pool of investors eligible to invest in project finance

ELTIFs have considerable potential to help further project finance distribution within the fund management community, but certain factors such as eligibility criteria are perceived to be inflexible. Usage of the ELTIF framework has so far been limited, with many institutional investors preferring other types of fund structures for project finance investment. The potential of the ELTIFs framework to offer an attractive “UCITS-like” framework for investment in illiquid assets is therefore not being fulfilled.

AFME supports the recommendations put forward by ICMA’s Asset Management & Investors Council to improve the ELTIFs framework in the following [Discussion Paper](#).

- **Benefit:** The need for investment into long-term assets in the EU is clearly understood. An effective ELTIFs framework should be instrumental for investment into small and medium-sized companies and infrastructures, including sustainability projects.
- **Priority:** Medium **Proposed completion:** 2024

4 Cross-cutting issues, including legal frameworks

4.1 Reviewing the EU securitisation regulatory framework, to improve the functioning of this mechanism vital to Europe's capital markets

The new framework for simple, transparent and standardised (STS) securitisation rightly constituted one of the building blocks of the CMU. Yet the potential of the STS framework and the ambition to have a safe and vibrant European securitisation market are so far not being fulfilled. We believe this is because an excessively complex regulatory framework and an overly conservative treatment of securitisation continue to discourage a meaningful recovery of the European market.

AFME has submitted a letter to the European Commission setting out our analysis and recommendations. We note below the top priority measures we recommend.

Recommendations:

- Significantly more generous treatment for STS securitisation under the Liquidity Coverage Ratio (LCR) – this requires re-examining eligibility levels and applicable haircuts for securitisation instruments⁷;
 - Recalibration of the securitisation prudential capital for banks and insurance companies⁸;
 - Improvements in the process for achieving significant risk transfer (SRT)⁹;
 - A proportionate approach for the supervision of ESMA disclosure template implementation;
 - Establishment of an STS framework for synthetic securitisations to enable banks better to manage risk and thereby support financing for the real economy¹⁰;
 - Establishment of a regulatory framework for ESG securitisation.
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- **Benefit:** The restoration of a well-functioning and safe European securitisation market is fundamental to the CMU. Our recommendations would be conducive to this objective.
 - **Priority:** High¹¹
 - **Proposed completion:** 2022.

We believe the measures noted above should be implemented as soon as practicable, making use of the opportunities offered by the upcoming CRR 3 and Solvency 2 packages and the Commission's empowerment to table proposals and put forward changes to delegated regulations.

4.2 Addressing tax-related obstacles to cross-border investment, including withholding tax, to deepen single market integration and cross-border investment

⁷ The benefits of the STS standard have not been reflected in regulation governing bank liquidity ratios, where an unlevel playing field persists with other fixed income instruments. To the extent that STS has had a positive impact, it has supported somewhat the bid by bank treasury investors for whom LCR-eligibility is important. A better treatment under the LCR would send a strong positive signal and encourage further investment.

⁸ The prudential capital framework for bank and insurance company investors in securitisation remains excessively conservative compared to other comparable investments. Revised capital charges for STS securitisations in Solvency II will enable the recovery of a non-bank investor base that has shrunk considerably in recent years, providing additional funding for the real economy, risk transfer possibilities for banks and removing distortions currently existing in the framework. Revised capital charges for banks will incentivise issuance and investor to help restore European securitisation markets.

⁹ Improvements are needed in the process for achieving significant risk transfer (SRT) transactions, for both performing and non-performing exposures (see also below re Article 9(3)). It is key to finalise the outcome from the EBA 2017 Discussion Paper including in particular clarification of the use of excess spread and addressing the anomalies in the CRT tests.

¹⁰ A new framework will provide greater opportunities for banks to transfer risk to non-bank investors, which if recognition of capital relief for the originator is permitted, will enable them to lend more to the real economy. Synthetic securitisation will be especially helpful to securitisation of large/midcap corporate, consumer and SME loans, which are both capital-intensive when held on balance sheet.

¹¹ The proposals listed above are all high priority measures to improve the functioning of securitisation in the EU (other secondary measures are noted in the letter referred to above).

AFME fully supports the intention of the High-Level Forum to propose measures to address tax-related obstacles to cross-border investment. The complexity of the taxation system is a major issue that specifically discourages cross-border investment, and that has a particular impact on private individual investors. There is a need for two types of reform. Firstly, there is a need for a major overhaul of the system of taxation of cross-border capital market investments to ensure that there is no discrimination in tax systems between domestic and cross-border investors, and between domestic and cross-border investments. Secondly, there is a need for efficient and secure operational processes that ensure that investors are taxed at the rate that is due (and not at some higher rate).

Inefficient withholding tax collection procedures, including the lack of a relief-at-source system, continue to be a prominent impediment to cross-border integration in EU securities markets. It is important that an investor in European securities is faced, not with 27 separate, and inconsistent, operational tax processes, but rather, to the greatest extent possible, with one process for the provision of tax information and of tax documentation. As a first step, the measures set out in the European Commission's Code of Conduct on Withholding Tax should be implemented in a harmonised manner across all EU member states by end 2024.

The withholding tax system for securities income should clearly distinguish in all countries between tax policy and tax process. Tax policy (tax rates, determination of which categories of activity are taxable, and determination of which categories of investor are liable for the tax) are a matter for member states. The operational tax process, including deadline for refund, should be harmonised across all countries.

Recommendations:

A future pan-European system that minimises the dissuasive effect on cross-border investment of national withholding tax procedures will have, at a minimum, the following characteristics:

- Possibility for cross-border investors to use both relief at source and reclaim procedures
- Level playing field in the treatment of intermediaries
- Efficient information transmission mechanisms, including mechanisms whereby information is stored at a level in the custody chain that is as low as possible, thereby minimising the need to transmit information up the custody chain, and minimising the need for duplicate records (as, for example, proposed by the TRACE system)
- Mechanisms to ensure the integrity of information (record date positions, identification of record date holders, etc) through the custody chain
- A common categorisation of investors
- Use of a single tax ID to identify each investor
- A common process for the certification of documents
- Rules on the attribution of tax benefits to be compatible with the future common definition of legal owner or "shareholder" (see recommendation 4.3) linked to a common definition of legal owner of a security
- Consistent application of the Record Date rule for the attribution of tax benefits
- Treatment of market claims as indemnities, and not as taxable dividends
- Ability for collateral givers (in triparty services, or more generally) to keep their entitlement to the applicable tax rate on their investment
- **Benefit:** Studies have estimated that procedures for withholding a tax reclaim are a significant cost to cross-border trading activities, estimated at roughly €8.4 billion per year¹². In addition to this cost to investors, we believe the benefits to European integration and cross-border investment would be very significant if these obstacles are addressed

¹² See CEPS "Europe's Untapped Capital Market: rethinking financial integration after the crisis", February 2016.

- **Priority:** High **Proposed completion:** 2024

4.3 Harmonising EU-wide definitions of key concepts in financial markets (e.g. financial instrument or legal owner of a security) and standardising rules and operational practices in post-trading, including corporate actions processing, to deepen integration and achieve legal and operational consistency

A truly integrated single capital market requires consistent definitions of fundamental legal and operational concepts. Without consistent definitions, investors and other market participants are faced with significant complexity and risk in their capital market activities.

Two important core concepts are those of financial instrument, and of legal owner (“shareholder”) of a security. (1) Without a consistent definition of financial instrument, market participants are faced with the reality that whether an asset is considered a financial instrument, and whether EU rules relating to financial instruments are applicable, may depend on different national definitions. (2) If national laws identify as the legal owner of a securities position a party in the custody chain other than the end investor, then this creates operational complexity, and the potential risk that the legal owner may be treated as the owner in the event of an insolvency, or with respect to the exercise of rights associated with the securities. The end investor is the party at the end of a custody chain that holds the securities position on a securities account provided by a CSD or an intermediary but that does not book those securities on any securities account provided by itself to a client.

Meanwhile, a lack of standardisation of rules and operational practices governing the attribution of entitlements to participate in corporate actions, and the exercise of those entitlements, increases the cost and risk of corporate action processing for end investors and for intermediaries (brokers and custodians). As a result, some end investors may not be able to exercise the rights associated with their ownership of securities, and end investors and intermediaries face barriers accessing national securities markets across the EU.

The upcoming review of the CSDR should be used to mandate a high degree of harmonisation in the operational process between issuers, issuer agents, and issuer CSDs with respect both to the issuance process, and to the corporate actions process.

- **Benefit:** Common EU-wide definitions of key concepts would contribute significantly to the integration of EU markets. Our recommendations on corporate actions processing would: allow investors a greater ability to exercise rights associated with corporate actions; reduce the cost and risk for end investors and for intermediaries of processing corporate actions; allow access by investors and intermediaries to additional national securities markets in the EU; enhance cross-border investment and reduce “home bias”.

- **Priority:** High **Proposed completion:** 2024

4.4 Improving and converging insolvency laws, to encourage all sizes of corporates to restructure their businesses more quickly and with more consistency, to increase overall investment interest in EU businesses

Strong insolvency rules promote deeper and more efficient capital markets and higher levels of entrepreneurship. The insolvency process is important for investors in a company. Investors need to be confident that, if the company in which they have invested becomes insolvent, they will be treated fairly, and they will be able to recuperate any funds that are due to them with not too long a delay. This applies to

situations within a single jurisdiction, as well as when doing business across borders in the EU. A holistic approach needs to be taken as measures taken in isolation will only deliver relatively marginal benefits.

Recommendations:

We identify four broad areas of work:

- Significantly improving inefficient insolvency procedures and targeted harmonisation of insolvency standards: this includes (1) establishing effective Chapter 11-type stay of proceedings in all member states to enable quick and effective restructuring; (2) special protection for new financing to provide working capital to a distressed company; and (3) stronger creditor rights; (4) creating a consistent framework for fast judicial resolution of valuation disputes;
- Addressing conflicts in insolvency rules;
- Taking steps to mitigate effects on third parties: the 2017 Report from the European Post Trade Forum [notably, the analysis relating to legal barriers (Barriers 8 to 11)] identifies additional measures that could be taken, including measures to deal with gaps in the Settlement Finality Directive (SFD) and the Financial Collateral Directive (FCD);
- Promoting the availability of out-of-court workout solutions: the Accelerated Extrajudicial Collateral Enforcement (AECE) proposal tabled by the Commission in 2018 should be taken forward subject to further consideration and amendment.

The HLF should also recommend requiring national insolvency agencies to regularly report on their results in order to better inform investors and policymakers.

- **Benefit:** Better functioning and more harmonised insolvency regimes across the EU have the potential to facilitate more predictable and orderly outcomes for corporate restructurings, reduce borrowing costs for issuers, attract investors and better safeguard their investments, and, overall, facilitate cross-border trade and investment. A 2016 AFME study offered a first estimate of the potential economic impact of insolvency reform in Europe. It showed that improving the insolvency recovery rate should reduce corporate bond spreads by 18 to 37 basis points. Applied across the economy, this lower risk premium could add 0.3% to 0.55% to EU GDP over the long-term, or between €41 and €78 billion¹³.
- **Priority:** High
- **Proposed completion:** We acknowledge the challenges in seeking to converge divergent insolvency frameworks which are deeply embedded in national legal systems. This workstream will require work over a longer period. We recommend establishing a roadmap with ambitious but realistic deliverables to be completed by 2024, with work to continue in the next political cycle.

4.5 Working towards European safe asset instruments, to support financial stability and broaden market liquidity

The development of safe assets – for example linked to instruments such as mortgage loans, sovereign debt and others – could provide a liquid source of high-quality collateral to support cross-border transactions and offer a risk benchmark to achieve a more efficient allocation of risk in the financial system. Euro-denominated safe assets could also serve the objective of deepening integration and advancing the economic and monetary union. Possible approaches to such instruments should be extensively studied in

¹³ In February 2016 AFME published 'Potential economic gains from reforming insolvency law in Europe'. Written in collaboration with economic consultancy Frontier Economics and international law firm Weil, Gotshal & Manges LLP, the report provides a comprehensive economic and legal analysis of the effects of Europe's fragmented insolvency laws. Available [here](#).

consultation with market participants to assess demand and avoid unintended consequences on the market, building on the existing body of work and research from various sources.

We recommend setting up a pan-European working group to explore at a technical level different approaches, with a view to issuing a report for consultation with market participants and consideration with EU political authorities. Such a technical group should comprise representatives from central banks, governmental authorities, the EU institutions and the range of market participants including investors, wholesale banks and other stakeholders.

- **Benefit:** The development of European safe assets would be a formidable opportunity to make European financial markets deeper, safer and more integrated, by: (1) acting a stabilisation factor, notably by helping to reduce the sovereign-financial nexus; (2) providing a deeply liquid source of high quality collateral to favor cross-border transactions; (3) offering a risk reference and helping to achieve a more efficient allocation of risk amongst the financial system; (4) serving the objective of fostering the international role of the Euro.
- **Priority:** High
- **Proposed completion:** This workstream will require work over a longer period. We recommend establishing a working group composed of public authorities and market participants to conduct research and produce a report with analysis on the feasibility of different approaches and recommendations for consideration.

Other measures for further consideration

We refer below to certain actions and ideas that require further research and discussion¹⁴.

1. Conducting further research on the availability of equity research on SMEs and midcaps and the impact of recent regulatory measures on analyst coverage

An area of reflection as part of CMU has been the availability of investment research on European companies, particularly SMEs and midcaps, in different member states and the potential effects of the MiFID 2/R inducements regime in analyst coverage.

Informal research by AFME – please refer to Annex 2 below – suggests that there has been a reduction in the number of European equity analysts over the last two years which coincides with the implementation of MiFID 2/R. The decline is more significant for shares listed on smaller European exchanges (including in the CEE region). There has also been a decline in analyst coverage of blue-chip shares listed on some of the largest European exchanges. UK listed shares are the main exception with no visible variation in analyst coverage neither for blue chip nor small caps.

Further research is needed before any measures are undertaken in this area; it is important to avoid unintended effects, such as introducing new costs and regulatory complexity for research providers.

2. Simplifying conditions and introducing more proportionality to investor protection requirements to support investment from sophisticated retail investors in risk capital, to widen the pool of capital available for start-ups and high growth companies

An area of reflection has been how to improve the channels for investment in risk capital and access to suitable products for different investor profiles, including high net worth individuals. While AFME supports the intention of improving conditions for expert retail investors to invest in venture capital and other forms of risk capital, further consideration of suitable mechanisms to advance this objective is needed before any legislative changes are considered.

AFME is of that view that (1) it should remain possible for retail clients to opt up into the elective professional category, subject to the conditions set out in the legislation under which a firm may treat a client as an elective professional client (including an assessment of the client); and (2) existing MiFID categorisations should not need to be reviewed; and (3) the upcoming review of MiFID 2/R is also an opportunity to iron out other problematic issues with respect to client categorisation and other related topics, such as the classification of newly established companies¹⁵.

AFME will be providing further feedback in its responses to the Commission and ESMA consultations on MiFID 2/R issues launched in 2020, which we will be pleased to share with the High-Level Forum.

3. Exploring new schemes to promote equity/risk capital investment, through new collaboration or consortium programmes

¹⁴ These ideas do not necessarily reflect AFME member positions and have not gone through our full committee governance process.

¹⁵ Currently a newly established company (therefore with no trading history) with assets <500,000 EUR has to be classified as a retail client. If such companies could draw on the trading history or assets of their principals (on whose knowledge and experience they can already rely), it would allow them, in appropriate cases, to opt up to elective professional status, which, generally speaking, is more appropriate for these entities.

Europe has a less developed private equity and venture capital industry than other regions such as the US. The availability of true equity for SMEs as well as sustainable finance investment (as recently cited by the ECB) could make a real difference to growth and job creation. A successful business model that could be considered on a regional basis in Europe is a pooled-equity consortium approach, such as the successful UK Business Growth Fund. This pooled vehicle, which could be structured either on a private sector or collaborative public/private cooperation basis, could attract significant expertise and equity investment at the European regional level, by local institutions, including financial institutions, interested in helping regions grow. Other types of public support for SME equity investment already exist, such as EIF guarantee programmes as well as those from national promotional banks. If well designed, and with a focus on crowding-in private institutional investors, these schemes may contribute to further long-term investments.

4. Enhancing the capacity at EU level to provide a level of guarantee on loans to SMEs, comparable to schemes under the US Small Business Administration

The Small Business Administration (SBA) in the United States facilitates loans to SMEs by offering partial guarantees, which also supports securitisation¹⁶. The SBA is the world's largest business loan guarantor with guaranteed loans worth circa \$30bn of loans pa.

Creating a similar single institution at the EU level with common budgetary support could bring several advantages, taking into consideration point 3 above and complementing the role of EIB/EIF and the schemes they already administer:

- **Ease securitisation and access to cross border financing:** Harmonising the current myriad of national guarantee products would allow greater transparency and convergence towards best practices in term of product design, which is a major challenge for Credit Guarantee Schemes (CGSs). This in turn would greatly ease securitisation and structuring of cross-border portfolios. It would, moreover, simplify prudential regulation issues, and notably the capacity of guarantees to provide capital relief for banks.
- **Ensure a level playing field:** A common approach would also offer a solution to the potential issues related to state aid rules associated with state guarantees and ensure a level playing field for SMEs across the EU.
- **Counter cyclical support:** Despite the increase in size of the various national programmes during the last financial crisis, borrowing cost of SMEs widened much more across the EU for SMEs than for large corporates, revealing the shortcomings of the current toolkits. Moreover, finding budgetary space to increase support programs in the depth of the crisis was more challenging for those member states where the sovereign and national banks came under pressure.
- **Protect the integrity of the CMU:** Combined, all three points above would help protect the integrity of CMU, ensuring that cross border financial flows are less at risk of sudden stops and reversal in crisis.

¹⁶ At present, the key difference between the European Union (EU) and the United States (US) is that in the EU the lead in supporting SMEs is at the national level whereas, in the US, it falls to the federal level through the Small Business Administration (SBA).

Annex 1

AFME informal comparison of SME Growth markets in Europe

Below we have listed the relevant benefits from small and medium sized companies to list on four SME Growth Markets, Nasdaq First North, Scale Germany, LSE AIM (UK) and Euronext Growth. All the markets provide for less market disclosure than would be required for the main market segment with associated free float and market cap limits too. None charges FTT (SDRT in UK) on SME growth markets.

One characteristic of the AIM market is the availability of various tax reliefs for investors as well as issuers which are not available in the same way to shares listed on the UK's main market (see table). As noted above, the enterprise investment scheme (EIS) and venture capital trust (VCT) schemes in the UK encourage investment in unlisted companies or companies listed in the AIM market.

In order to foster greater investment in European SME growth markets, investors could be encouraged by similar or new schemes to incentivise investment whilst providing relief if the company fails.

Nasdaq First North Growth Market (373 securities)

Requirement	Nasdaq First North Growth Market
Free float	10%
Market Cap.	n/a
Corporate Governance	n/a
Accounting Standards	Local
Info disclosure	Less than main market
Prospectus requirements	Less than main market
Market cap	<€500mln or issued secs €20mln

- Supported by certified adviser – monitors company compliance with listing rules, rather than the exchange for main market
- Company must demonstrate that it has “sufficient resources” to conduct planned business for 12 months
- Process of issuing draft prospectus, application for listing and admission to trading takes 2-3 months
- Requires financial and legal advisors.

AIM UK (851 securities currently listed)

Requirement	AIM
Free float	None
Trading record	None
	Nominated advisor
Market capital	None
Accounting Standards	3 year's audited info
Company history	
Tax	https://www.londonstockexchange.com/companies-and-advisors/aim/publications/a-guide-to-aim-tax-benefits.pdf
Stamp duty	Shares exempt

Minimum amount to be raised	GBP6mln
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- Company must demonstrate that it has enough working capital to continue business for 12 months
- The tax reliefs available include: — Capital gains tax (CGT) – gift relief – Entrepreneurs’ Relief — The Enterprise Investment Scheme (EIS) — Inheritance tax (IHT) – business property relief — Relief for losses — Venture Capital Trusts (VCTs).

Euronext Growth (244 securities currently listed)

Requirement	Euronext Growth
Free float	
Trading record	2 years (unless exemption granted)
Market capital	
Accounting Standards	National
Company history	
Stamp duty	
Minimum amount to be allocated	€2.5mln

Scale Germany (49 securities listed)

Requirement	Scale
Fulfil at least 3 of the following criteria	
Free float	At least 20 per cent free float or at least 1 million free float shares
Number of employees	>20
Cumulated equity capital pre IPO	>€5mln
Earnings	0
Equity capital	0
Accounting Standards	National
Company history	>2 years
Market cap	Approx. €30mln
Company history	2 years

Annex 2

AFME informal research on the evolution of equity research coverage post-MiFID 2/R

From January 2018, MiFID 2/R required research to be priced separately from execution. This represented a major shift from previous market practices whereby research was supplied as part of a bundle of services, with no explicit charge.

Some market participants and policymakers have noted that among the unintended consequences of the research unbundling rules is the decline in equity research coverage and the deterioration in the quality of company research.

We have prepared an informal analysis on the evolution of equity research coverage of European and US stocks over the last six years with intention of illustrating the impact of MiFID unbundling rules on the provision of research for European companies.

This informal research concludes that there has been a reduction in the number of European equity analysts over the last 2 years which coincides with the implementation of MiFID 2/R. The decline is more significant for shares listed on smaller European exchanges (including in the CEE region). There has also been a decline in analyst coverage of blue-chip shares listed on some of the largest European exchanges.

The declining trend, in some cases, pre-dates MiFID 2/R entry into force. However, in many cases there is an abrupt coverage decline in 2017-18.

UK listed shares are the main exception with no visible variation in analyst coverage neither for blue chip nor small caps.

This note addresses the impact of MiFID 2/R unbundling rules on research coverage but does not evaluate any potential impact on the quality of research or on pricing and potential cost reduction for asset managers.

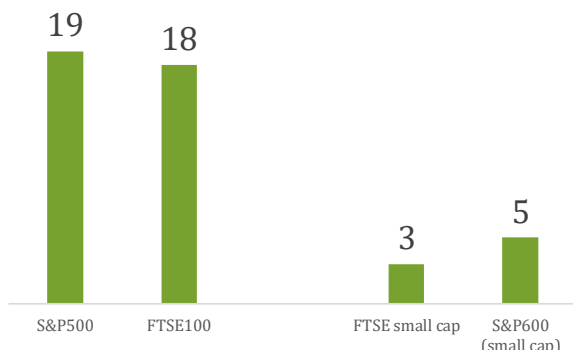
1) Number of equity analysts is positively correlated with company size and market cap

Firm size is a major determinant of research coverage. The largest constituents of the FTSE100 have a median of 18 analysts producing notes and valuation forecasts. Small constituents of the FTSE small cap index have a median of 3 analysts, while 36% of the constituent companies have no research coverage at all.

The same trend holds (with some figures variation) in the US and across EU exchanges, such as the companies listed on the Italian stock exchange. See charts 4.1 and 4.2

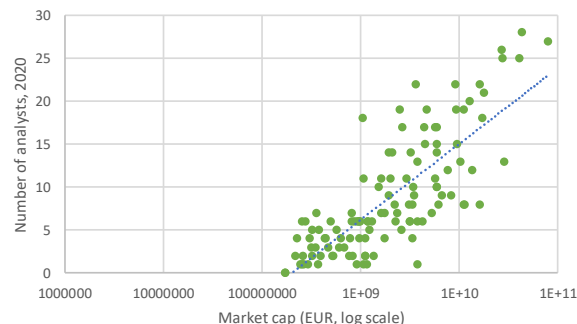
This illustrates that, even in the absence of MiFID 2/R unbundling rules, coverage of small companies is structurally scarce and small publicly listed companies face a disadvantage against larger companies from a research coverage perspective.

4.1 Median number of analysts of constituent companies of selected equity indices: Feb 2020



Source: Eikon

4.2 Italy: Market capitalization of Italian listed shares and number of analysts per share: Feb 2020



Source: Eikon. Each dot represents a listed company

2) Decline in analyst coverage in some blue-chip indices post-MiFID 2/R

According to Eikon data, over the last two years there has been a decline in analyst coverage of some blue-chip shares listed on some of the largest European exchanges.

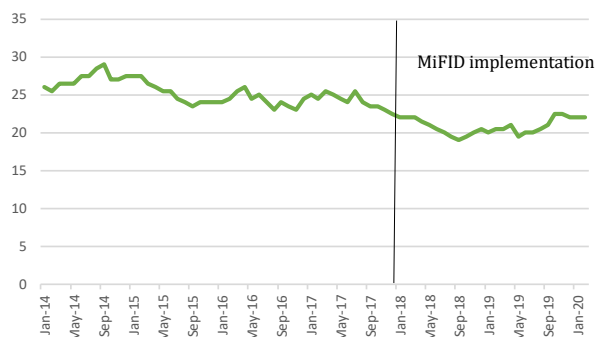
The decline is not of the same magnitude across all exchanges. FTSE100 and some of the developed markets blue chip indices are the exception, while there is a large and significant steep decline in analyst coverage of shares listed on Central and Eastern European (CEE) exchanges.

The declining trend, in some cases, pre-dates MiFID 2/R entry into force. However, in many cases there is an abrupt coverage decline in 2017-18.

To summarise some of the findings:

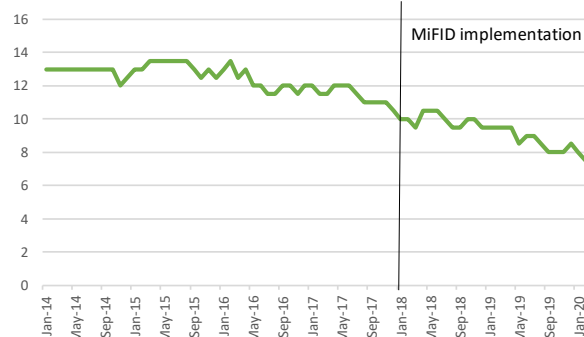
- The number of analysts covering AEX (Amsterdam) constituent shares declined from **25** in 2017 to **20** in 2019. There has been a recent increase since the second part of 2019.
- The number of analysts covering CAC40 (France) constituent shares declined from **25** in 2017 to **21** in 2019. There has been a recent increase since the second part of 2019.
- The number of analysts covering ATX (Austria) constituent shares declined from **12** in 2017 to **8** in 2019. The decline has continued in 2020.
- The number of analysts covering CROBEX (Croatia) constituent shares declined from **3** in 2017 to **1** in 2019.
- The number of analysts covering FTSE100 constituent shares has not materially declined over the last two years. In 2017, a median number of 19 analysts covered the FTSE100 companies, compared with 18 in 2019.
- To compare with other jurisdictions, S&P listed companies have a median of 19 analysts per stock, virtually unchanged from 20 observed in 2017.

4.3 Median number of analysts of AEX [Netherlands] constituent shares



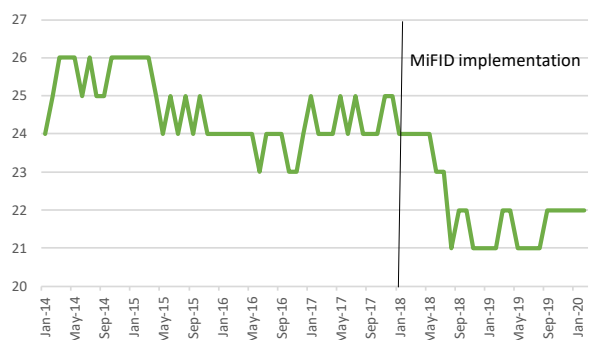
Source: Eikon

4.4 Median number of analysts of ATX [Austria] constituent shares



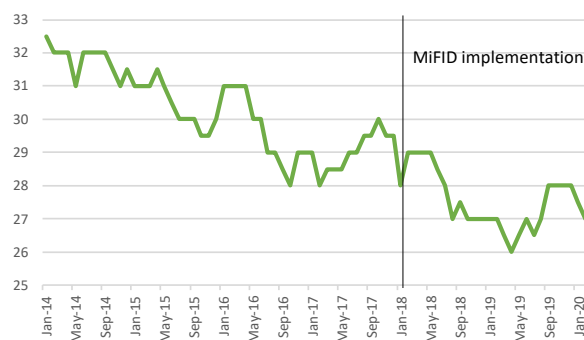
Source: Eikon

4.5 Median number of analysts of CAC40 [France] constituent shares



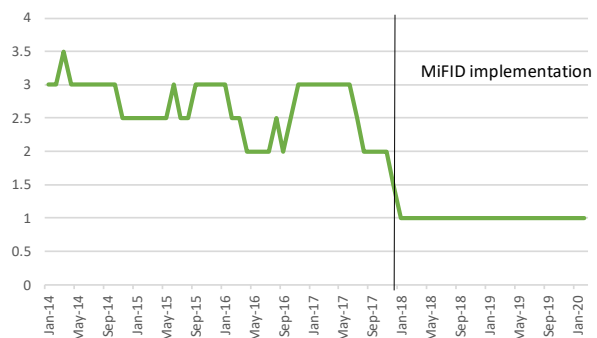
Source: Eikon

4.6 Median number of analysts of DAX30 [Germany] constituent shares

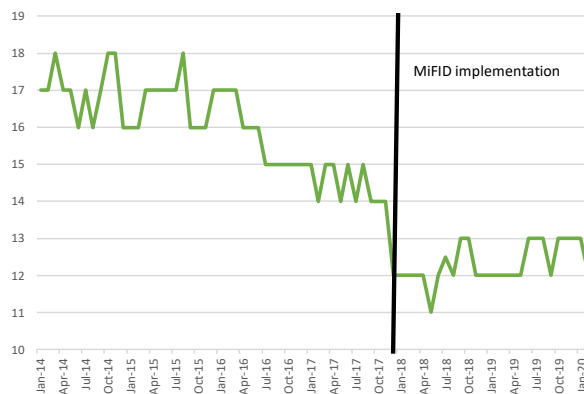


Source: Eikon

4.7 Median number of analysts of CROBEX [Croatia] constituent shares

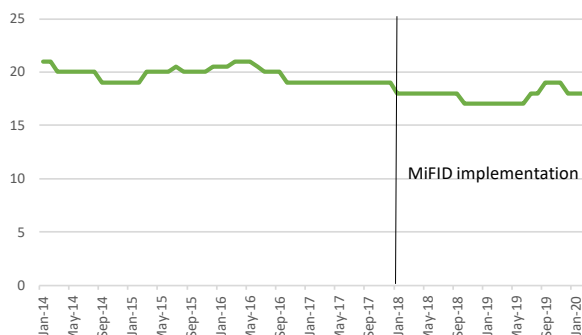


4.8 Median number of analysts of New Europe [CEE] constituent shares



Source: Eikon

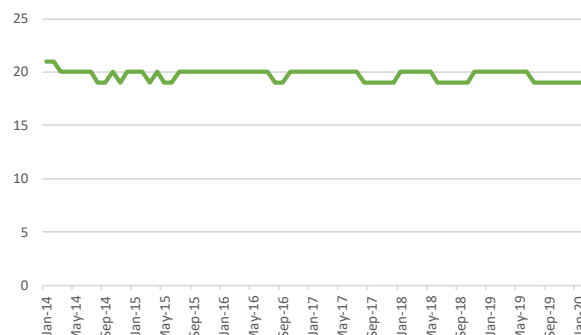
4.9 Median number of analysts of FTSE100 constituent shares



Source: Eikon

Source: Eikon

4.10 Median number of analysts of S&P500 constituent shares



Source: Eikon

3) Decline in analyst coverage of small cap companies.

We find a decline in the number of analysts covering small cap European firms after MiFID II implementation. The decline is not of the same magnitude across all exchanges, while for UK small caps there is no visible change in equity coverage over the last two years. To summarise some of the findings:

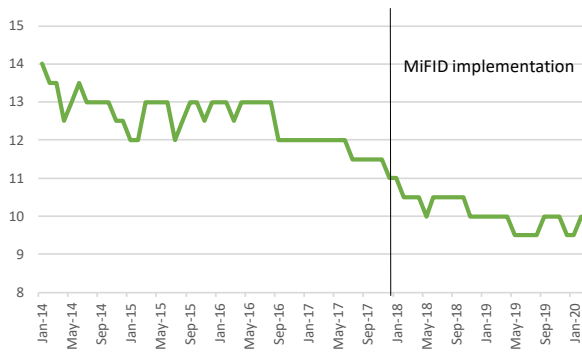
- Decline in small cap German companies from a median of **12** in 2017 to **10** in 2019
- Decline in small cap Swedish companies from a median of **2** in 2017 to **1** in 2019
- Decline in small cap Euro area companies from a median of **13** in 2017 to **11** in 2019, but with recent increase possibly due to new market participants
- Decline in small cap Danish companies from a median of **1** in 2017 to **0** in 2019
- FTSE small cap constituent shares had a median of 4 analysts in 2017, the same number than in 2019.
- S&P small caps have seen a minor decline in analyst coverage from a median of 6 analysts in 2017 to 5 in 2019.

The additional challenge for SME companies is that the decline in analyst coverage can also imply completely losing equity coverage. According to Fang et al (2019)¹⁷, 334 firms completely lose their analyst coverage in Europe following the implementation of MiFID. Most of these firms (305 firms; 91%) had only one analyst following in 2017.

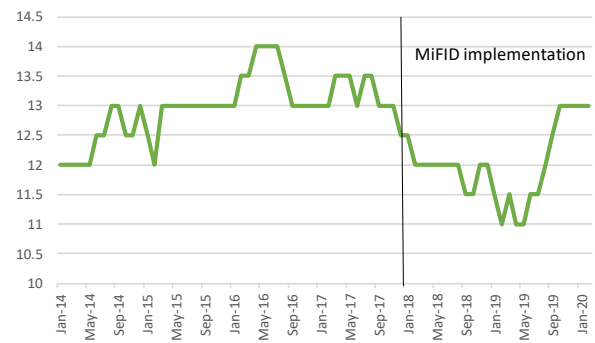
4.11 Median number of analysts of CBOE Germany small cap index constituent shares

4.12 Median number of analysts of EURO stoxx small cap [euro area] constituent shares

¹⁷ Bingxu, Fang, Hope, Ole-Kristian, Huang, Zhongwei and Moldovan, Rucsandra, Rotman School of Management Working Paper, 'The Effects of MiFID II on Sell-Side Analysts, Buy-Side Analysts and Firms', 2019

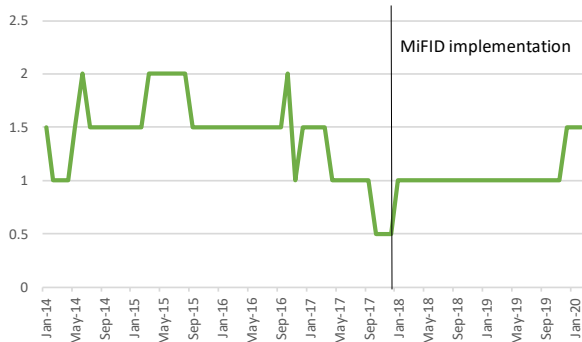


Source: Eikon



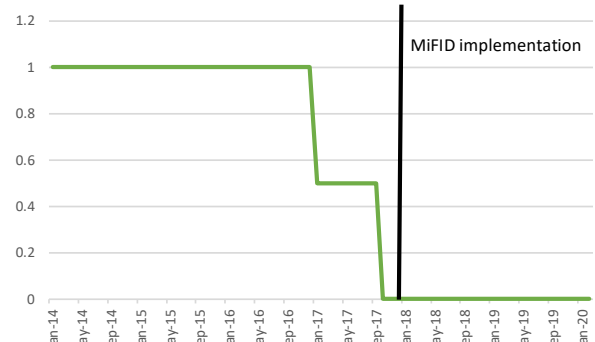
Source: Eikon

4.13 Median number of analysts of OMX Stockholm small cap index constituent shares



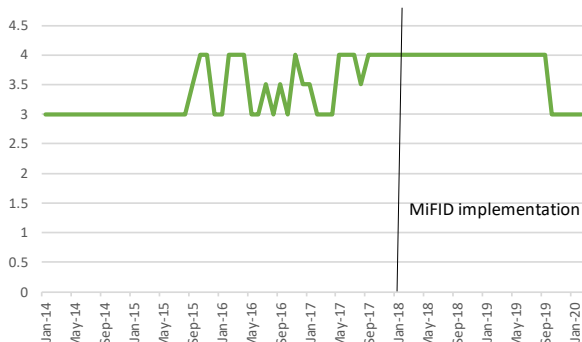
Source: Eikon

4.14 Median number of analysts of OMX Copenhagen small cap index constituent shares



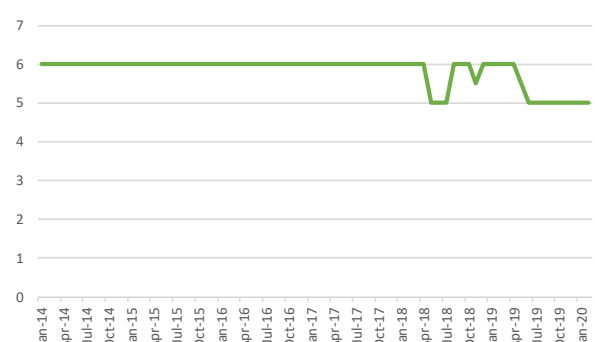
Source: Eikon

4.15 Median number of analysts of FTSE small cap constituent shares



Source: Eikon

4.16 Median number of analysts of S&P small cap constituent shares



Source: Eikon