Capital Markets Union Mid-Term Review

Public Hearing, Brussels, 11 April 2017

Opening speech by Mr. Valdis Dombrovskis, Vice President of the European Commission

Link to the speech:

https://ec.europa.eu/commission/commissioners/2014-2019/dombrovskis/announcements/capital-markets-union-opening-remarks-vice-president-dombrovskis-public-hearing-capital-markets_en

Panel I: The road to the CMU in 2019: CMU implementation so far and key challenges and priorities for the mid-term review

Moderated by David Wright, Eurofi

Panellists: Marcus Pleyer, *Deputy Director General, Federal Ministry of Finance, Germany;* Corso Bavagnoli, *Head of Department for Economy Financing, Ministry of Finance, France;* Neena Gill, *British Member of the European Parliament, Labour Party;* Leo Arduini, *AFME Board Member, Head of Markets in EMEA at Citigroup;* Christian Thimann, *Group Head of Regulation, Sustainability and Insurance Foresight, AXA and Chair of the Commission High-Level Group on Sustainable Finance*

Opening Remarks by Guntram Wolff, Director of Bruegel

In his opening remarks, Guntram Wolff emphasised the importance of CMU in diversifying financing of the EU economy and in so doing to achieve higher growth and minimise systemic risk. He underlined the need to increase cross-border integration for more liquidity and risk-sharing, where capital markets were even more important shock absorbers than fiscal policies. Going forward, he called for: (i) continued efforts to develop a true single rulebook for capital markets; (ii) an enhanced role of ESMA to compensate for the reduced role that UK authorities will play in oversight of European capital markets post-Brexit; (iii) central supervision for Central Clearing Counterparties (CCPs) and auditors; (iv) strong insolvency and financial restructuring frameworks, including comparative data thereon; and (v) a coherent approach to tax reforms to support capital market development.

Panel discussion

Marcus Pleyer expressed strong support for using CMU to strengthen capital markets as a complement to (and not substitute for) bank credit to business. He also welcomed the CMU method, based on careful preparation rather than precipitative action. He welcomed in particular the new prospectus regime and Solvency II amendments to reduce the capital charges for investments in infrastructure, and urged a strong focus in the mid-term review on equity finance and venture capital. He also called for quick finalisation of the legislation on securitisation. CMU can do more to bolster bank financing and should place a strong focus on proportionality in the banking rulebook. Better functioning secondary markets were needed for Non-Performing Loans (NPLs) alongside more transparency and more efficient national insolvency regimes. A European blueprint for national bad banks might be useful. However, this should stop short of 'mutualisation' since NPLs were primarily a national issue.

Loan-originating funds could unlock significant amounts of funding; the pertaining risks might warrant harmonised regulation. FinTech has the potential to lower costs, enhance market efficiency and boost financial inclusion. For the time being, Germany would prefer industry guidelines for personal pension products over legislation. Pleyer welcomed the Commission's two-pronged approach of harmonisation and interaction with Member States through the European Semester in order to identify and remove barriers to cross-border capital flows. National structural reforms are critical to developing capital markets and unleashing new growth dynamics, more generally. Technical assistance is precisely what is needed to develop the geographical reach of capital. Brexit reinforces the urgency to make progress on CMU in EU-27 setting.

Corso Bavagnoli concurred that not enough credit has been given to the Commission as regards the progress made so far towards CMU. Looking forward, further adjustments to Solvency II are needed for securitisation to recover. He welcomed the Commission proposal on preventive restructuring of companies as an ambitious first step in the field of insolvency harmonisation. It integrates some innovative procedural features like 'cross-class cram-down'. He stressed the need – under the CMU mid-term review - for reforms that bring about substantive harmonisation of insolvency law. Protection of secured creditors, which presently differs widely across the EU, should be the starting point; this will support bank lending by creating confidence that banks will be able to recover at least part of the debt. France is in principle very supportive of an EU personal pension product. In addition to providing a new vehicle for investors to provision for retirement, it will also help insurers to diversify their liabilities across borders.

Neena Gill, MEP recalled the political support afforded to CMU by the European Parliament from the very beginning and called for increased ambition and careful identification of priorities for the coming years. Risk transfer to the capital markets could help to free up bank lending capacity. She took note of concerns about the complex and challenging securitisation negotiations; it is hoped to reach agreement between co-legislators under the Maltese Council Presidency. The ECON Committee is preparing reports on both covered bonds and FinTech, a significant enabler for cross-border financing which should become an integral part of CMU. European Funds for Venture Capital and for Social Entrepreneurship, sustainable finance, Solvency II adjustments for investments in infrastructure, and retail financial services are key initiatives. She also singled out personal pension products, noting that EU initiatives must contain effective solutions that deliver tax deductibility and portability. Cross-border barriers to capital flows must be addressed. The benchmarking exercise of the efficiency of loan enforcement and insolvency systems is also important.

Leo Arduini heralded CMU as a vital initiative for global corporate investment banks, including for risk management. He welcomed a number of achievements under the CMU, such as (i) the new prospectus regime, (ii) the proposal for preventive restructuring, and (iii) the benchmarking of insolvency systems whose efficiency was paramount, particularly as regards the protection of secured creditors. The liquidity of secondary markets for all asset classes is key and the upcoming report of the European Post-trade Forum warrants careful consideration, as does the impact of MiFID II. To unleash bank lending capacity, NPLs need to be resolved and securitisation must be simple if it is to win acceptance by the market. The success of the European Fund for Strategic Investments (EFSI) should be built upon and the regulatory agenda must address the shortage of risk capital. Personal pensions are also a priority.

Christian Thimann shared his insights from his perspective as Chair of the Commission High-Level Expert Group on Sustainable Finance. Sustainability risks must be incorporated into financial risk assessment by (i) providing a vision for sustainability, (ii) integrating sustainability in the policy framework, and (iii) mobilising market finance for sustainable projects. Financial sustainability risks have to be integrated into corporate decision-making and the financial system has to be calibrated to focus more on social inclusion, environmental protection and long-term decisions. Focus is needed on: (i) fiduciary duties and the Environmental, Social and Governance (ESG) dimension in corporate decision-making; (ii) credit rating agencies; (iii) regulation of ESG disclosures via the Delegated Acts for prospectuses; (iv) transparency and research on long-term risks under MiFID II; (v) clear and effective approaches to ESG disclosure under the forthcoming non-financial reporting guidelines; and (vi) measures to support the continued success of green bond markets. Financial regulation needs to overcome the tension experienced by the business community which is torn between short-term, mark-to-market requirements and the growing policy/investor emphasis on the integration of longer-term considerations and externalities in investment decisions.

Panellists viewed Brexit as increasing both the challenges and the urgency of CMU. C. Bavagnoli underlined (i) the need to rebuild depth and liquidity of EU capital markets, (ii) the risk that beneficial competition between trading venues could degenerate into market fragmentation absent a consolidated tape, and (iii) the urgency to perfect the Banking Union single rulebook, e.g. by effectively preventing national ring-fencing. Supervision post-Brexit would need to compensate for the impending loss of the UK supervision over a large share of capital markets. It will need to be underpinned by a clear framework on equivalence vis-à-vis the UK as a third country, which will enable EU-27 to manage significant risks in view of the still considerable capital flows to be expected between the EU and the UK. C. Bavagnoli urged the Commission to focus on delivering effective and near-term improvements to the functioning of the European Supervisory Authorities' (ESAs) mission rather than become side-tracked by unproductive reflections on twin-peaks versus current sectoral architecture. MEP N. Gill added that the ESAs should give higher priority to investor protection. Panellists unanimously subscribed to the importance of early commitments in order to encourage institutional strengthening and forge long-term arrangements with the UK.

Panel II: Promoting access to finance for SMEs

Moderated by William Wright, Director, New Financial

Panellists: Stefano Micossi, *Director General, Assonime, Member of the Board of European Issuers*; Deirdre Somers, *President, Federation of European Securities Exchanges*; Petr Koblic, *CEO, Prague Stock Exchange*; Gerry Murphy, *Chairman, Invest Europe, Senior Managing Director and Chairman of Blackstone Europe*; Oliver Gajda, *Executive Director, European Crowdfunding Network*

Opening Remarks by Karen Wilson, Bruegel and OECD

Karen Wilson welcomed the CMU mid-term review as an opportunity to step up the CMU agenda. SMEs are faced with a wide variety of situations and needs. While Europe seems to perform well in terms of promoting start-ups, scaling-up is a serious issue and more action is needed to promote scale-up financing.

Venture capital should be further developed, in order to finance SMEs beyond the first round. K. Wilson illustrated this need by highlighting that venture capital in Europe remains lower than in the United States in all rounds of financing, with the gap increasing as companies grow. This is deemed all the more crucial as 40% of venture capital in Europe stems from public sources. It could notably be fruitful to investigate how to bring more institutional investors into the asset class.

K. Wilson also advocated promoting venture debt to complement venture capital. This means of funding is underdeveloped in Europe, while it has become prevalent in financing "unicorns". Developing this form of financing could notably help provide working capital for growing companies that have not reached a size enabling them to do an Initial Public Offering (IPO).

Finally, K. Wilson called for IPO opportunities to be enhanced in Europe, as they remain less prevalent than in the US by a factor of ten. European markets need to become more attractive, with more dynamic secondary markets and more exit options for those unable to do an IPO or a trade sale. This is crucial as it could help avoid that start-ups created in Europe are acquired by US firms in the face of scarce European opportunities.

Panel discussion

The panel was generally critical of the increased regulatory burden for SMEs and the lack of proportionality that characterises EU financial legislation applicable to issuers, intermediaries or trading venues. Panellists argued that existing regulation had generally been designed with large organisations in mind, and did not cater for the situation of small issuers or small stock exchanges.

Similarly, it was argued that the ecosystem for supporting small issuers in coming to market is under severe threat. Several panellists pointed out that there are currently few analysts, brokers or underwriters who can afford to support smaller issuances because of high regulatory overheads. MiFID II rules on SME research are seen as an immediate threat to research coverage of any but the largest tier of issuers. The panel called for these provisions to be corrected before it is too late to avert the damage. It was also stated that the EU market abuse regime is excessively burdensome for small issuers.

It was noted that venture capital funds in Europe lack the necessary size to provide needed funding for scale-ups. Most panellists stressed that scale-ups need at least as much attention, if not more, as start-ups. New data was cited to support the thesis that Europe's problem is not with start-ups, but with expansion/scale-up finance.

At the same time, without start-ups there would be no scale-ups or listings. Market systems and policy frameworks need to be adequately designed for start-ups and not only for high-growth companies, as approaching all issues from the perspective of the "unicorns" could hinder the objective of having more growth and jobs. It was also argued that crowdfunding needs to be better integrated in an inter-connected European pre-IPO funding system. This would help develop new solutions increasingly used by business angels, venture capital funds and institutional investors.

It was argued that investment in SMEs will remain local for the foreseeable future. Hence, some panellists believed that the policy focus should be on developing local ecosystems before developing cross-border ecosystems. National authorities have a key role and responsibility to play in this regard by using tax and other local policy levers. The moderator in particular felt that the impetus needs to come from bottom-up: EU-led, top-down initiatives cannot legislate the right investment environment into existence.

One panellist stressed that high-net worth and sophisticated individual investors did not need the protections granted to retail investors. The challenges of broadening share ownership to retail investors were also underlined. Some panellists suggested that broadening retail investors' exposure to funds investing in listed SMEs or micro-cap funds was the best way forward, rather than promoting direct investment.

Speech by Mr. Jyrki Katainen, Vice President of the European Commission

Link to the speech:

https://ec.europa.eu/commission/commissioners/2014-2019/katainen/announcements/remarks-progress-capital-markets-union_en

Panel III: Better investment opportunities for retail and institutional investors

Moderated by Ugo Bassi, Director, DG FISMA, European Commission

Panellists: Guillaume Prache, *Managing Director, Better Finance;* Benoit Lallemand, *Acting Secretary General, Finance Watch;* Frank Roeters Van Lennep, *Chief Investment Officer Private Markets, PGGM;* Olav Jones*, Deputy Director General & Director Economics and Finance, Insurance Europe;* Alexander Schindler*, President, EFAMA*

Opening Remarks by Gabriel Bernardino, Chair, European Insurance and Occupational Pensions Authority (EIOPA)

EIOPA is strongly supportive of an effective **Pan-European Pension Product (PEPP)**, which would meet two CMU objectives: (i) provide solid returns to citizens saving for retirement, and (ii) support long-term investment in the economy. Currently, pension products are too costly. This is in large part due to the fragmentation of this market along national lines, resulting in a lack of competition. Proceeds are often not invested in long-term assets, reducing capacity to tap higher returns. An effective PEPP would not substitute for, but work in parallel to national products. It should be designed so as to be simple, cost effective, transparent, standardised, but also flexible. As a financial guarantee would close down flexibility and add greatly to cost, other solutions to deliver capital protection should be considered. It should be invested in long-term assets, meaning that a minimum holding period should apply. It should benefit from an attractive tax regime and a favourable treatment of long-term liabilities in Solvency II.

EIOPA supports **more transparency of the cost and performance of long-term investment products** (including a PEPP), and therefore the creation of a database with their main disclosures.

Supervisory convergence needs to be a priority of the CMU. EIOPA needs to receive a clear mandate from the European Commission to improve supervisory convergence.

Panel discussion

The panellists stressed that CMU is about serving retail investors and the real economy. It will link savings with sustainable investment. Being part of the third pillar of the Investment Plan for Europe it will help long-term, sustainable investment in the EU economy. Progress by the European Fund for Strategic Investments (EFSI) in supporting investment in infrastructure and SMEs was welcomed by the panel.

Direct investment by European retail investors in capital markets remains minimal, lack of trust being the main issue. One panellist underlined that most retail investment products are not even delivering an inflation-proofed return on capital. The European Commission's leadership on transparency of retail investment products and tackling the high costs of product distribution is seen as crucial. This panellist noted that this was one of the few areas where the European Commission has not delivered its commitments under the original CMU Action Plan. Progress is badly needed. The removal of past performance from mandatory fund disclosures was seen as a retrograde and regrettable step. At the same time, « there is no free lunch »: more return entails more risk, and education of retail investors towards a capital markets-focused culture is needed. One panellist highlighted the potential contribution of Employee Stock Ownership Plans (ESOPs). FinTech may facilitate engagement by retail investors.

All panellists underlined the urgency of creating a PEPP that would deliver solid returns to retail investors. The idea of making enrolment automatic and creating a simple default investment option was suggested.

Long-term liabilities of pension funds and insurance companies should be invested in long-term assets. A stable regulatory framework was seen as important for institutional investors. One panellist viewed capital requirements for insurance companies against asset classes such as equity as overly conservative. However, it was observed that current equity holdings of insurance companies reflected a change in asset-liability management introduced after the dotcom bubble and equity holdings had not declined since the introduction of Solvency II.

A critical constraint to institutional investment in SMEs is that smaller insurance companies and pension funds do not have the scale to conduct due diligence on SMEs and infrastructure assets. They need access to diversified, well managed funds which do the project selection for them (e.g. venture capital funds / European Long-Term Investment Funds (ELTIFs)).

More leadership on sustainability is needed with an economic vision, including common taxonomy, definition and standards (ESG criteria, green bonds…).

Panel IV: Improving the functioning of the single market by removing barriers to cross-border flow of capital

Moderated by Fabrice Demarigny Head of Capital Markets Activities, Mazars, France and Chair of the European Capital Markets Institute (ECMI)

Panellists: Daiga Auzina-Melalksne*, Head of Baltic Exchanges, Nasdaq Baltic;* Märten Ross*, Deputy Secretary General for Financial Policy, Ministry of Finance, Estonia;* Joël Merère*, Independent Member of the Eurosystem Market Infrastructure Board (T2S) and T2S member of the European Post-Trade Forum;* André Küüsvek*, Director, Local Currency and Capital Market Development, EBRD;* David Hiscock*, Senior Director, Market Practice and Regulatory Policy, International Capital Market Association*

Opening Remarks by Fabrice Demarigny, Head of Capital Markets Activities, Mazars, France and Chair of ECMI

Supervision of capital markets should be a priority of the CMU given its role in facilitating market integration and cross-border transactions. There is a lack of trust between national competent authorities and market players. Supervision can help address this issue which is a structural impediment to cross-border investment. Some changes to the powers of ESMA and the other ESAs might be needed in order to enable ESMA to better perform its tasks. But differentiation may be warranted as regards the role and potential adjustments to the framework in which each ESA operates. The CMU mid-term-review is an opportunity to think about how to remove the barriers and create an integrated and a more autonomous capital market. This reflection is badly needed now given the imminent withdrawal of the biggest financial hub.

Panel discussion

Europe needs capital markets which are available, accessible and affordable. CMU is not about a one size fits all approach: there is a need for targeted responses depending on the market segments and the size and risk profile of market players. The cost of regulation for smaller entities was pointed to by some panellists. It is necessary to reduce the regulatory burden on smaller entities in order to allow them to operate. The need for a more proportionate approach in regulation is even bigger in smaller markets.

Tailored responses are needed to support the development of local market ecosystems. Technical assistance can help. EU best practices are welcome in developing local ecosystems. The EU regulatory framework should avoid erosion of local ecosystems and help the development of local markets.

The panellists underlined the need to develop sound and efficient market infrastructure. Post-trading is a key dimension of CMU affecting the whole trading chain. The CMU mid-term review is the right time to tackle outstanding Giovannini barriers, as well as more recent sources of fragmentation in post-trading. These are long-standing barriers and action is overdue. The potential of distributed ledger technology (DLT) is very high, but too many issues remain today to see it as a panacea to post-trading challenges.

As regards capital market supervision, an important challenge for CMU is to foster trust between national supervisors and market players. The public consultation on the operation of the ESAs which was launched by the Commission in March is the opening step in an important reflection on significant opportunities for optimising the role of ESMA in ensuring effective and consistent capital market supervision.

To realise the full potential of CMU, there is a need to remain open to inward investment from third countries into the EU. This calls for there being open, competitive EU capital markets underpinned by a well-functioning repo market, the development of which will require careful attention and a range of actions to alleviate current stresses.

Closing Keynote Speech by Steven Maijoor, Chair, European Securities and Markets Authority (ESMA)

Supervisory convergence is a key pillar in reinforcing CMU because it ensures a consistent approach to achieving financial stability, investor protection and orderly markets, as well as contributes to removing barriers between Member States. These issues and the need to increase the effectiveness of cross-border supervision are highlighted in the Commission's public consultation on the operations of the ESAs.

Work on fostering supervisory convergence is complex and combines various tools: some general, such as guidelines, Q&As and opinions; some legislation-specific, for example ESMA's participation in supervisory colleges, the conduct of an EU-wide stress test for CCPs or the upcoming banning powers under MiFID II.

The departure of the UK from the single market reinforces the need to focus on supervisory convergence in order to eliminate risks of regulatory and supervisory competition and a potential race to the bottom, for example in relation to the supervision of outsourced activities. ESMA is currently working towards developing a convergent position on key issues to be taken into account when market participants move some of their activities from the UK to the EU-27.

The experience so far shows that some of ESMA's supervisory tools are too weak to ensure convergence, especially in those areas where specific sectoral legislation does not provide ESMA with greater powers than the general ones. For example, in the asset management area, which is very important for retail participation in the single market, ESMA would benefit from specific convergence powers such as those to ensure consistent authorisations across the EU.

As for the general convergence tools, ESMA's ability to collect information should be improved and the scope of breach of Union law powers clarified. A bolder strategy on financial data will also be a key element for an improved functioning of the single market for capital and facilitated cross-border supervision.