IRSG
INTERNATIONAL REGULATORY STRATEGY GROUP

IRSG response to *Building a Capital Markets Union*

Introduction

The International Regulatory Strategy Group (IRSG) welcomes the European Commission's ambition to create a single market for capital in Europe to increase competitiveness, jobs and growth for all 28 Member States. This formal response to the Capital Markets Union (CMU) consultation will focus on the ways in which financial markets can better serve Europe's people and businesses by identifying obstacles to deep and liquid pools of capital and making proposals for the removal of those impediments.

The IRSG is a practitioner-led and cross-sectoral body comprising leading figures from the UK-based financial and related professional services industry. It seeks to identify opportunities for engagement with governments, regulators and European and international institutions to promote an international framework that will facilitate open and competitive capital markets globally. It is an advisory body both to the City of London Corporation and TheCityUK.

The free movement of capital is one of the founding principles of the European Union and the fact that is has not yet been fully realised, 58 years after the Treaty of Rome, affects the ability of businesses across the continent to access the finance which they need to grow. While banks will continue to be a major source of finance for businesses, the creation of a diverse ecosystem of finance through a CMU would increase choice for corporates, enabling them to access finance more quickly and more cheaply. The effective allocation of capital and risk across national borders is essential for sustainable growth – both the buy-side and sell-side are inhibited by fragmented markets.

This response by the IRSG is part of an ongoing engagement with the Commission's CMU project which began at its inception with a statement of the seven principles that should inform a CMU. These are:

1. Dynamic and innovative capital markets can facilitate sustainable economic growth
2. A CMU should include all 28 Member States
3. The global competitiveness of the EU's financial sector should be maintained
4. Financial stability, investor protection and market integrity are essential elements of sustainable capital markets
5. Europe can benefit from innovation and new technologies
6. Non-legislative and market-based solutions approaches should be used wherever possible
7. Capital markets development can work in tandem with other policy priorities

The approach that has been taken by the Commission, emphasising the fact that CMU is a Single Market project of all Member States which seeks bottom-up, market-based solutions rather than a top-down focus on supervisory architecture, is welcome.

Delivering a Single Market in Capital for Corporates

The need for increased access to capital by small and medium enterprises (SMEs) and in particular the safe restarting of securitisation markets and expansion of private placements is not a new concern and has been discussed by TheCityUK in a 2013 report by Ares & Co[1]. In this response, the IRSG will also draw on research carried out by EY for TheCityUK on the experience of mid-sized corporates across six Member States and four industry sectors in accessing capital.

Delivering a Single Market in Capital for Savers, Investors and Pensioners

The benefit of a Single Market in capital for savers, investors and pensioners builds on the IRSG's previous report *Finance for Jobs and Growth in Europe* and will be further examined in a forthcoming report on individuals and retail markets due for publication in 2016.

Openness and Regulatory Coherence

CMU is an important initiative of the Commission, but it should not be seen in isolation. The reconfiguration of the Commission, to link the work of Commissioners and Vice-Presidents with the overall aim of promoting competitiveness, jobs and growth and achieving better regulation is important. In this response, the IRSG makes recommendations on openness and regulatory coherence.

Long-Term Finance for Infrastructure

The Investment Plan for Europe and a Single Market in capital are closely linked. The IRSG has made recommendations about how the Commission, Member State Governments, regulators and supervisors, corporates and the financial services industry can work together to overcome obstacles to investment in infrastructure and SMEs in a previous report[2] and makes further recommendations in this response.

Technology and Innovation

This response also addresses the potential for technology and innovation to be drivers of more effective access to financial services in the future and stresses the need for partnership between industry and government to facilitate innovation. In this, as in other parts of the response, the IRSG has been mindful of the fact that Europe's CMU cannot be constructed in isolation but must be an outward-looking project which enables competitiveness in the global economy and responds to both challenges and innovations from beyond the EU.

As well as responding to the Commission's concurrent Prospectus Directive consultation, TheCityUK, at the invitation of the UK Chancellor of the Exchequer, is conducting a review of the European listings regime. This review will inform the debate about CMU by making recommendations on how the current European listings regime could be improved with a view to encouraging new listings, particularly from growth companies.

The IRSG, although UK-based, is international in outlook and supports a number of bilateral Member States Financial Services Dialogues between senior practitioners from our industry. The Anglo-French

[1] TheCityUK/Ares & Co. *Alternative Finance for SMEs and Mid-Market Companies*, 2013
[2] IRSG *Long-Term Finance for Infrastructure and Growth Companies in Europe* 2015

and Anglo-Italian Financial Services Dialogues have also welcomed the CMU initiative, with the Anglo-French Committee having made its own response to the consultation and the insights of the Anglo-Italian being incorporated in this response, in particular relating to credit information about SMEs. The expanding work of these bilateral dialogues will continue to contribute to the debate about how to achieve the Commission's vision of a Single Market for Capital in Europe.

Key Recommendations

Themes	Recommendations
Delivering a Single Market in Capital for corporates	• Share best practices and facilitate public and private initiatives aimed at increasing awareness of alternative finance options for SMEs. • Targeted policy measures in the area of institutional loans and increasing corporate bond market liquidity that can help large firms. • We would echo the UK Government's proposal for a root-and-branch review of the EU's corporate bond market with a focus on how liquidity can be improved and the impact of post-crisis regulatory reforms. • For many Member States, structural economic reforms, including reform of insolvency laws and protectionist and anti-competitive practices, will be most important to increasing access to finance. • Review how credit bureaux and central bank credit registries can better facilitate the disclosure of credit information for SMEs seeking alternative sources of finance. • Highlight the benefits and share best practices in the tax treatment of private placements, to support the creation of a pan-European market. • Reduce the requirements for, and allow greater use of, incorporation by reference for a prospectus in the case of secondary issues to make it easier for companies to get additional funding based on an existing listing. • Support the revival of securitisation markets, including through loan guarantees from the European Fund for Strategic Investment. • Additional data reporting requirements should be kept to a minimum and it will be important to harmonise the various existing systems if they are to enhance financial integration cross-border. Consideration should be given to how the ECB's AnaCredit initiative might help in this respect. • Ensure that MiFID II is implemented in a way that does not allow for the unlawful obstruction of cross-border consolidation of financial markets infrastructure.
Delivering a Single Market in Capital for savers, investors and pensioners	• Consider whether a horizontal approach to the marketing of retail investment products is warranted. • Consider whether legal obligations upon national competent authorities to ensure suitability and best execution are being properly discharged. • Consider whether there is a level playing field for non-traditional platforms for the distribution of and guidance about investment products, including with respect to digital distribution. • While a European pension system is unlikely to meet the subsidiarity test, more could be done at the European level to share best practice

and encourage all Member States to move to a system of funded pensions.

- Some current regulations are at odds with the stated ambitions of CMU and hamper the ability of funds to divert private investment in long-term illiquid assets. For example, the prudential requirements in IORP II, Solvency II (standard model) and CRD IV currently penalise investment in infrastructure and other long-term projects. These should be revisited in light of the CMU.
- Encourage EU measures to reduce costs for setting up funds and marketing them across borders, in order to lower barriers to entry and create more competition. One way to do this would be through the incorporation of a marketing passport for third country AIFMs. A reduction in the scope for national gold-plating, e.g. requirements for paying agents, would also support this.
- When impact assessments and cost-benefit exercises are being conducted the individual costs associated with each piece of legislation should be examined alongside the cumulative cost of regulation as it affects a particular sector rather than simply being assessed on a stand-alone basis.

Long-Term Finance for Infrastructure

- There is no shortage of money to finance infrastructure projects, but more 'shovel-ready' projects are required in the pipeline.
- The European Commission's Investment Plan acknowledges the need to improve access to financing for infrastructure and the role that capital markets can play to address the intermediation gap between the supply and demand for long-term financing. The European Commission should continue to allocate sufficient resources to the implementation of this project.
- Political and economic uncertainty in the EU partially explains why long-term investment is lagging even though there is liquidity in the market. While the IRSG acknowledges that regulatory certainty on a national level is beyond the remit of European institutions, European activity, i.e. the forthcoming EIOPA investigation into insurance investment in infrastructure projects, also creates uncertainty among investors which needs to be better managed.
- Consideration should be given to a more proportionate and risk-sensitive prudential treatment for institutional investors, including the calibration of Solvency II and IORP II.
- Asset frameworks need to be revisited so as to allow banks, insurers, pension funds and UCITS funds to invest in ELTIFs.
- Openness to investors and providers from outside of the EU is crucial as Europe competes with the rest of the world to attract long-term investment.
- The IRSG supports and calls for the consistent and effective enforcement of the principles identified by the OECD to favour

macroeconomic conditions that are conducive to longer-term investment.[3]

- The cooperation between private and public sector investors needs be improved and expanded.

Openness and regulatory coherence

- Introducing US dollar tranches in debt facilities would boost liquidity by attracting stable and strong US institutional investors. The US private debt market, in particular, has proven its ability to accommodate complex EU infrastructure transactions.
- Non-EU investors can provide Euro funding but they need to protect their currency position. Although that protection does not typically impact EU borrowers, it may provide expensive to unwind in the event of early repayment of a transaction. In such cases; international investors need to be made whole on currency swaps associated with the remaining life of the instrument, through a "Swap breakage" clause.
- An extension of the marketing passport to both non-EU AIFMs and non-EU AIFs would have a positive impact on competition and choice within the EU internal market for EU professional investors[4].

Technology and Innovation

- The IRSG supports the implementation of a 'digital investment passport', which would securely hold savers' administrative information and make investment advice and guidance more easily accessible for a broader segment of savers.
- The proposed EU Data Protection Directive and Regulation are important in setting standards for data protection, but it is essential to consider the broader realities of data in the world today in the context of mobile, cloud and internet.
- The European Commission and ESAs should collaborate on an initiative to facilitate discussion between firms and authorities about how new technologies and distribution channels can be developed.

[3] OECD, *G20/OECD High-level principles of long-term investment financing by institutional investors*, September 2013,
[4] BlackRock, *Response to the Call for Evidence – AIFMD passport and third country AIFMs,* 2015.

CAPITAL MARKETS UNION (CMU)

TheCityUK
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The free movement of capital is one of the fundamental freedoms of the European Union and should be at the heart of the single market. Yet despite progress, capital markets remain fragmented and typically organised on national lines. Access to these capital markets varies across the 28 Member States, where they are characterised by a home bias.

Capital markets have expanded significantly in the EU in recent years.

TOTAL EU STOCK MARKET CAPITALISATION

TOTAL VALUE OF OUTSTANDING DEBT SECURITIES IN THE EU

However, EU investment levels are considerably below the norm due to more stringent regulation and post-crisis de-leveraging, which has led to the tightening of bank lending in certain countries.

Despite this growth in EU capital markets, it remains relatively low compared to the US, where the equity market is significantly bigger than that of the EU.

STOCK MARKET CAPITALISATION AND DEBT SECURITIES AS A PERCENTAGE OF GDP

350% 236%

There are currently six main barriers to creating a single market for capital in the EU

1. Administrative Obstacles
2. Financial Regulation
3. National Practice
4. Investor / Saver Customs & Culture
5. Lack of Education / Information
6. Risk Aversion

Creating a single market for capital by removing the obstacles to the movement of capital between retail customers and investors, and the projects and corporates where it is needed, will result in a virtuous circle, benefiting those lending and those borrowing the capital.

A VIRTUOUS CIRCLE OF CAPITAL BENEFITING RETAIL CUSTOMERS, INFRASTRUCTURE PROJECTS AND HIGH GROWTH COMPANIES

EASIER ACCESS TO THE CAPITAL NEEDED
– faster more reliable supply of funding across the 28 Member States enabling capital to be channelled to where it is needed most.

MORE INVESTMENT FOR HIGH GROWTH COMPANIES
– greater availability of finance when and where it is needed to enable growth and create jobs.

NEW INFRASTRUCTURE INVESTMENT

BETTER RETURNS FOR RETAIL CUSTOMERS

Delivering a Single Market in Capital for corporates

Consultation questions:

2) What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?

4) Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?

5) What further measures could help to increase access to funding and channelling of funds to those who need them?

6) Should measures be taken to promote greater liquidity in corporate bond markets, such as standardisation? If so, which measures are needed and can these be achieved by the market, or is regulatory action required?

10) What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

15) How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

16) Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

20) Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

23) Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

30) What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

Recommendations

- Share best practices and facilitate public and private initiatives aimed at increasing awareness of alternative finance options for SMEs.
- Targeted policy measures in the area of institutional loans and increasing corporate bond market liquidity that can help large firms.
- We would echo the UK Government's proposal for a root-and-branch review of the EU's corporate bond market with a focus on how liquidity can be improved and the impact of post-crisis regulatory reforms.
- For many Member States, structural economic reforms, including reform of insolvency laws and protectionist and anti-competitive practices, will be most important to increasing access to finance.
- Review how credit bureaux and central bank credit registries can better facilitate the disclosure of credit information for SMEs seeking alternative sources of finance.

- Highlight the benefits and share best practices in the tax treatment of private placements, to support the creation of a pan-European market.
- Reduce the requirements for, and allow greater use of, incorporation by reference for a prospectus in the case of secondary issues to make it easier for companies to get additional funding based on an existing listing.
- Support the revival of securitisation markets, including through loan guarantees from the European Fund for Strategic Investment.
- Additional data reporting requirements should be kept to a minimum and it will be important to harmonise the various existing systems if they are to enhance financial integration cross-border. Consideration should be given to how the ECB's AnaCredit initiative might help in this respect.
- Ensure that MiFID II is implemented in a way that does not allow for the unlawful obstruction of cross-border consolidation of financial markets infrastructure.

Introduction

Policy measures aimed at increasing access to finance for corporates should be properly targeted given the diversity of firms and funding conditions in Europe. Most of Europe's largest corporates have public equity listings, regularly issue debt securities, and use derivatives to hedge financial risks. In the Eurozone, equity is the most important source of corporate finance for non-financial corporations (listed and non-listed), relative to GDP. However, although equity is the most important source of outstanding finance in all the main Eurozone economies, its overall importance varies significantly, with the value of outstanding equities in 2014 standing at 250% of GDP in France and just under 90% in Germany.[5] Large firms generally report good access to capital markets; targeted policy measures in the area of institutional loans and increasing corporate bond market liquidity can help these firms.

Europe has 21.2 million SMEs and there is significant heterogeneity amongst them[6]. The EU defines SMEs as having fewer than 250 employees and €50m turnover, with micro enterprises defined as those with fewer than ten employees and less than €2m turnover. The availability of finance varies widely between Member States, with 7% of Austrian SMEs reporting assess to finance as their most pressing problem compared to 32% in Greece. Many SMEs—including the vast majority of micro-enterprises—are best served by financing their operations through retained earnings or bank facilities. Bank financing remains the most important source of funding for SMEs. The ECB reports that 61% of SMEs cite bank lending as their most relevant source of finance followed by a bank overdraft which was cited by 53% of respondents; 45% cited leasing as their most relevant source of funding while 35% listed public grants.[7]

A survey by the UK's National Endowment for Science, Technology and the Arts (NESTA) shows that the 6 per cent of fastest growing UK businesses accounted for half of the new jobs created by existing businesses between 2002 and 2008.[8] Though diverse in many ways, evidence shows that these fast-growing businesses exhibit a high level of innovation.[9] Equity financing (e.g. venture capital) is often

[5] Centre for Economic Policy Research, *Restarting European Long-Term Investment Finance: A Green Paper Discussion Document*, 2015.
[6] ECB, *Annual Report on European SMEs 2013/2014: A Partial and Fragile Recovery*, 2014.
[7] ECB, *Survey on the Access to Finance of Enterprises in the Euro Area*, 2014.
[8] NESTA, *The vital 6 per cent: How high-growth innovative businesses generate prosperity and jobs*, 2009.
[9] NESTA, *Business Growth and Innovation: The wider impact of rapidly-growing firms in UK city-regions,* 2009.

well-suited to this small number of innovative, high-growth firms.[10] For policymakers concerned about nurturing these businesses, the relative scarcity of equity sources such as VC in Europe is problematic. In 2013, North American venture capital fundraising comprised around 60% of the global total compared with just 14% for Europe.[11] In 2013 venture capital accounted for less than 10% of total fundraising in Europe[12], indicating considerable scope for growth. This figure masks considerable regional variation in the prevalence of venture capital, with regional contributions to total European VC funding ranging from nearly 50% in France and the Benelux region to around 5% on the Iberian peninsula[13]. Our ambition is for Europe to have a greater number of innovative, high growth firms that are able to access equity finance, delivering attractive risk-adjusted returns for investors and driving employment growth.

CMU is most likely to benefit medium-sized enterprises reaching a scale where alternative funding would be appropriate. There is evidence that the time and expense associated with accessing capital markets dissuades medium-size firms from listing.[14] For many corporates, the tax advantages associated with debt leverage mean that it is in any case a more attractive source of finance compared to equity. For smaller SMEs, the primary benefits will be indirectly derived from initiatives such as securitisation and use of whole loans which can free up bank balance sheets for additional SME lending.

One structural factor that hinders European corporates' access to cross-border finance is the fragmentation within the Single Market and the poor information available to investors. While financial integration among Member States is improving from post-crisis lows, divergent approaches to accounting standards, tax treatment and securities law continue to hinder cross-border flows.[15]

For many Member States, structural economic reforms, including reform of insolvency laws and protectionist and anti-competitive practices, will be most important. Wider use of central credit registries and facilitating their availability to non-banks would be another positive step. European institutions have a role in sharing best practice across Member States, and promoting regulatory coherence. In general, deregulatory measures should be prioritised and new legislation or institutional arrangements should require a high burden of proof.

Questions 2, 5, 15 & 16

Barriers to financing medium-sized corporates

Corporate perspective of CMU

TheCityUK and EY have collaborated on research to bring a corporate perspective to the debate around CMU.[16] This research involved a survey of medium-sized corporates across six Member States including France, Germany, Italy, Latvia, Poland and Portugal. These Member States were chosen to represent an indicative balance of countries across the north, south, east and west of the EU, with different population sizes and levels of financial development. Firms were chosen from four high-growth sectors (pharmaceutical, biotechnology, advanced engineering and information technology). When interviewed, C-suite executives at these firms highlighted five areas where they felt CMU could be helpful to their businesses:

[10] Aghion, P., *From Growth Theory To Growth Policy Design.* LSE Growth Commission, 2012.
[11] EY, *Adapting and evolving: Global venture capital insights and trends,* 2014.
[12] ECVA, *European Private Equity Activity*, 2013.
[13] *Ibid.*
[14] TheCityUK/EY, *Capital Markets Union: A corporate perspective*, forthcoming.
[15] ECB, *Financial Integration in Europe*. 2015.
[16] TheCityUK/EY, *Capital Markets Union: A corporate perspective*, forthcoming.

1. Increasing familiarity with, and availability of information on, alternative sources of finance.
2. Reducing costs and burdens associated with alternative sources of finance, especially disclosure obligations, regulatory requirements and compliance costs.
3. Increasing the amount of expertise and advice available from financial partners, including operational expertise from venture capitalists, feedback after funding declinature and referrals to alternative sources of finance.
4. Developing a richer ecosystem of non-bank finance providers, including venture capital, peer-to-peer and state supported guarantee schemes.
5. Reducing dependence on bank financing, particularly to mitigate pro-cyclical credit squeezes.

Questions 5 & 16

Financial services policy solutions

There are a number of policy interventions which we believe could help address the areas identified in TheCityUK/EY corporate survey.

Securitisation

Securitisation is critical to the success of non-bank alternative finance because history shows that it can generate truly meaningful levels of funding for SMEs and others. However, these securitisation markets need to be restarted if they are to make a difference to alternative finance. It will be easier to mobilise market participants if the underlying loans tend to be larger and more from mid-market companies rather than smaller SMEs.[17]

Securitisation, which is ultimately a funding method for banks, has contracted in recent years.[18] There are three key reasons for this. One is the reputational damage done to securitisation associated with sub-prime residential mortgage assets in the US.[19] Another reason is the calibration of capital requirements related to securitisation, which do not sensitively distinguish between plain-vanilla securitisation and riskier types. Finally, today's accommodative monetary policy means that securitisation is not an attractive source of funding for banks. As monetary policy tightens, securitisation has the potential to be a more important source of funding for banks and thus the wider economy.

We welcome efforts by the ECB and Bank of England to revive securitisation markets. Identifying plain-vanilla, un-tranched securitisations will be key. The avoidance of financial engineering greatly reduces regulatory problems and appears to increase the attractiveness of these schemes for investors. There are other actions by public authorities that can help revive these markets, including loan guarantees from the European Fund for Strategic Investment.

Questions 4 & 30

Private Placement

[17] TheCityUK / Ares & C., *Alternative Finance for SMEs and mid-market companies,* 2013.
[18] TheCityUK / Ares & Co., *Alternative Finance for SMEs and mid-market companies,* 2013.
[19] It should be noted that the underlying assets of European securitisation suffered much less impairment.

It is clear that private placement markets are expanding rapidly in France, Germany, and the USA. The well-established private placement markets in the USA and Germany are also attracting foreign companies in significant numbers showing that there is strong international demand for this type of financing. The German market has in recent years attracted a number of non-German borrowers who in 2013 accounted for 36% of issuance.[20]

We support efforts to grow pan-European private placement markets, including the project led by the International Capital Markets Association on standardisation of private placement documentation, that TheCityUK participated in. Certain European countries have improved the tax treatment of private placements, another important step toward the creation of a pan-European market. Best practices in the tax treatment of private placements should be spread across the EU and the IRSG supports initiatives like the withholding tax exemption on interest on private placements introduced by the UK Government in 2014.[21]

Question 6

High yield

Another way to smooth the transition between exclusive bank financing and public markets is the development of high yield bond markets, which are less prevalent in Europe compared to the US.[22] We would echo the UK Government's proposal for a root-and-branch review of the EU's corporate bond market with a focus on how liquidity can be improved and the impact of post-crisis regulatory reforms.[23] We would also suggest that consideration be given to the market in whole loans[24] and institutional loans.

Prospectuses

We welcome the Commission's consultation on the Review of the Prospectus Directive and believe this this will be an important means of reducing the burden on corporates hoping to list. TheCityUK is responding to this consultation separately, but the IRSG's core recommendations include:

- The quality of disclosure in prospectuses should be improved (i.e. disclosure should be shorter and of higher quality (particularly in the risk factors section and summary)). The reform of the current prospectus summary is a top priority and a format similar to the key information document required for PRIIPS may be appropriate.
- Reducing the requirements and greater use of incorporation by reference for a prospectus in the case of secondary issues would make it easier for companies to get additional funding based on an existing listing. Raising the threshold for the number of investors above which a requirement to issue a prospectus is triggered would facilitate business progression for companies at different stages of growth.

[20] PwC, *German private placements attract international borrowers*, 2013.
[21] Slaughter & May, *UK and European Private Placement Markets,* 2015.
[22] Goldman Sachs, *Unlocking Europe's economic potential through financial markets,* 2015.
[23] HM Treasury, *Building a Strong Capital Markets Union*, 2015.
[24] See Blackrock, *Capital Markets Union: An investor's perspective*, 2015.

- The market practice of having a black-out period following the publication of research should be addressed, possibly by creating clearly defined safe harbours for research, in order to shorten the IPO Process.
- Multilateral Trading Facilities (MTFs) which are utilised more often by SME type companies should remain outside of the scope of the prospectus directive.

Questions 2, 10 & 20

Information and financial education

Financial education

Financial institutions, professional services providers and governments all have a role to play in promoting a better understanding of the complementarity of debt and equity financing. One of the ways Member States can help is to provide user-friendly platforms to educate firms on the variety of available funding options, building on the EU's finance portal.

The European Commission should use its convening power to share best practice about financial education for SMEs. Examples of good practice include initiatives aimed at educating SMEs on capital markets finance (e.g. the London Stock Exchange's ELITE programme and Euronext's Enternext programme) and mentoring businesses to improve their finance capabilities (e.g. Goldman Sachs' 10,000 Small Businesses programme and the Better Business Finance Taskforce's Mentorsme programme).

One of the chief obstacles identified by the IRSG with respect to SMEs considering non-bank finance is the burden associated with information disclosure. Greater use of credit bureaux and central credit registries is one way to ease this burden and we would recommend that the Commission reviews best practice and what might be improved.

Initiatives like the Business Growth Fund (BGF) should be promoted and extended. The BGF was established in 2011 to unlock the potential of fast-growing UK businesses that need long-term capital to drive their future success. Backed by five of the UK's main banking groups – Barclays, HSBC, Lloyds, RBS and Standard Chartered – BGF is an independent company with up to £2.5bn with which to make long-term equity investments. Not only does the BGF finance companies, but it also provides mentoring support.

Question 2

Information disclosure for SMEs

Better financial education of growth companies would allow them to explain their business models in an investor-friendly way. High growth companies also face other obstacles to fulfilling their potential to innovate and create jobs. One is that potential providers of finance do not have the relevant information to assess their creditworthiness. Information about SMEs should be easily accessible and understandable in every Member State.

Question 16

One significant hurdle for SMEs to access alternative sources of finance is the additional amount of disclosure needed compared to an application for bank credit. A number of systems exist in Europe to provide financial data on corporates, including credit bureaux and central bank credit registries. This information is a useful tool to evaluate clients'

creditworthiness and, in general, for better credit risk management. It fosters the sound and prudent management of reporting institutions and improves the quality of their lending, finally resulting in an increase of the overall stability of the credit and financial system. We support the availability of this information to providers of finance (banks and non-banks) in principle, with appropriate vetting, injunctions against use of this information for marketing and robust data protection standards. Any effort to improve this system or offer a European solution should be preceded by a thorough review of the various systems and their costs and benefits. Additional data reporting requirements should be kept to a minimum and it will be important to harmonise the various existing systems to enhance financial integration cross-border. Consideration should be given to how the ECB's AnaCredit initiative might help in this respect.

Availability of research

Recent legislative initiatives have limited the extent to which research provision can be bundled with other services, which has the potential reduce the availability of research. It is likely that smaller firms will be worst affected by this. Policymakers should take stock of the impact of recent legislative and consider ways that this channel for such information dissemination to be made economical.

Other salient policy factors

Corporate finance and monetary policy

The interest rate and monetary policy environment has a substantial impact on the availability and cost of finance. When central banks unwind their asset purchase programmes and raise interest rates, there is a risk that healthy firms will find it harder to access finance. The CMU agenda is an important way to diversify channels of financial intermediation to lessen the impact on firms.

Question 16

Corporate finance and tax policy

Tax and legal environments in Europe tend to favour debt finance over equity finance, an entrenched bias which has developed over time. Allowing the deduction of debt interest costs has incentivised debt financing, while there is no similar treatment for the costs incurred in raising equity. Using the tax system to make equity a more attractive financing source has the potential to spur innovative businesses for which equity financing is most appropriate.

Question 5

Proactive measures to stimulate crossborder investment like enterprise networks

One recommendation would be to develop Enterprise Networks that extend across Member State borders to improve the risk rating and reduce the cost of finance for growth companies. Enterprise Networks in Italy facilitate the aggregation of different enterprises to foster their competitiveness and innovation in both domestic and foreign markets. An Enterprise Network which receives a positive evaluation for its business plan is enabled to gain access to finance. The positive evaluation of the Network's business plan can also improve the risk-standing of participating firms, resulting in a reduction of financing cost

for them. Developing harmonised rules at EU level on the working of such business networks could favour the aggregation of growth companies from different Member States thereby further improving their financial and commercial standing and access to finance. The European Commission should learn from the Italian model and encourage other Member States to follow their example under harmonised rules developed by the European Commission.

Spotlight on Financial Transactions Tax (FTT)

The proposed FTT will present a significant impediment to achieving a CMU as it would impose a disproportionately large burden on marginal investment projects. The FTT will make alternative sources of financing much less attractive than bank lending, which will be outside of the scope of the tax:

- *Equity:* The impact of FTTs on shares has been well documented by the IMF and others[25]. While the exact impact will depend on the tax rate and the frequency with which the shares are traded, a 10bp tax would reduce the value of a company's shares by 7.6% and increase their cost of capital by about 25bp in participating Member States.
- *Bonds:* According to analysis by London Economics, the impact of the FTT on corporate bonds would be between 6% and 13%, depending on maturity, in the EU11. This would increase the cost of funding by around 22.6bp for participating Member States[26].
- *Private equity:* The European Private Equity and Venture Capital Association estimates that the FTT would increase the cost of the average private equity investment by 0.6-0.8% in the EU11[27].
- *Securitisation*: Like equity and debt, securitised products in the EU11 would also be subject to the tax, leading to similar increases in costs for issuers and investors.

As exemplified above, the net effect of the FTT will be to increase the cost of capital for businesses in Europe. This will not be solely due to the direct cost of the FTT to issuers but also due to the indirect cost as a result of the cascade effect and the liquidity premium paid.

For instance, although a 0.01% tax on derivatives seems negligible, the real cost to users will be much higher for the following reasons:

- The tax is levied on the notional amount, which is many multiples larger than the economic value of the contract.
- Derivatives contracts are often short-term in nature and will be rolled-over many times, leading to the FTT being charged multiple times.
- Dealers will hedge their exposure in the interdealer market, leading to additional cost (the so-called "cascade effect").
- Counterparties are required to post collateral, which could also be subject to the FTT.

If the cost of derivatives were to increase due to the FTT, companies would either bear the additional cost of hedging, which in turn would impact on their business and their customers, or

[25] See Matherson, Thornton, *Taxing financial transactions: Issues and evidence*, IMF working papers, 2011.
[26] London Economics, *The Impact of a Financial Transaction Tax on Corporate and Sovereign Debt*, 2013.
[27] European Private Equity and Venture Capital Association (EVCA), *Financial Transaction Tax: a report for the EVCA on the implications for private equity.* 2014.

they may decide not to hedge these risks. This would translate into more volatility in their cash flows, requiring them to maintain higher cash reserves which would otherwise have been put to useful investment.

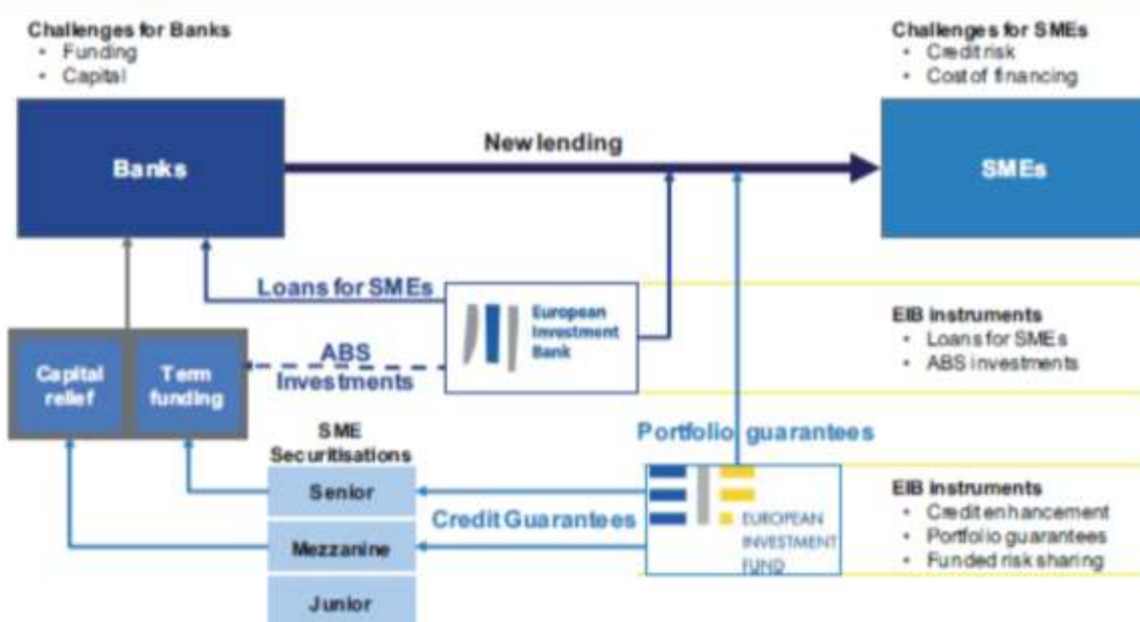
Finally, a measure that would only be adopted by 11 of the 28 Member States will increase the fragmentation of Europe's capital markets and will disincentivise capital flows across borders. In particular, it will disincentivise cross-border flows between participating and non-participating Member States, as investors outside the zone will likely choose an investment in their own country or in another non-participating Member State which would not be subject to the tax.

The key aim of a CMU in Europe is to reduce the fragmentation of financial markets across the EU. However, FTT would have a detrimental effect on Europe's capital markets and the effects of the tax would directly contradict the objectives set out for a CMU in Europe. This measure would be harmful to economic growth in the EU and should therefore be re-considered in light of the new push towards a CMU and long-term finance.

State support

The European Investment Fund (EIF) provides various kinds of guarantees to market participants when they participate in securitisations. The EIF is currently very engaged to restart the European SME securitisation market. It has sought to encourage SME securitisations by providing financial guarantees in senior, mezzanine and first loss tranches (see figure below) of SME securitisations or on loan portfolios sales. While these institutions are recognized for their valuable catalytic effect, they must also be vigilant to not crowd out private investment.

SME Alternative Funding Support from the EIF and EIB



Investment in or guarantees of mezzanine financing can provide considerable reassurance to investors in more senior tranches. It is probable that these guarantees from the EIF have secured the

participation of a number of investors who would not otherwise have participated in various securitisations. The EIF is thus capable of mobilising significant new funds into securitisation markets. This may then incentivise other investors to take part in the securitisation. The leverage effect of encouraging a multiple of EIF support is a core principle for the Fund, and the estimated effects are shown below.

The EIF also has a 'Mezzanine Facility for Growth' which invests in hybrid debt/equity funds throughout Europe. The purpose of this asset class is to provide alternative finance to support, for example, entrepreneurs who seek additional finance but do not wish to lose ownership control of their companies. Funding for MFG is €1bn. As of 2013, the EIF's commitment helped to deliver nearly €30bn of SME financing.

Spotlight on Post-Trade

Post-trade infrastructure has an important role to play in making CMU a reality: it provides the "plumbing" that brings together providers and users of capital across the continent. When it is inefficient, it puts up barriers; when it is efficient it eases the flow, so that both providers and users have the widest range of options available to them.

The current post-trade infrastructure is reflective of the nature of the EU – a multi-currency area consisting of 28 Member States. Initiatives such as T2S, linkages between CSDs and CCPs spanning multiple markets have gone some way towards a fully integrated European capital market. However, it remains true that a European investor cannot easily choose between investment opportunities from one end of the continent to the other. Similarly, it is not easy for a foreign investor to look at Europe as a single investment destination. For the professional and retail investor alike, the cost of investing from Portugal to Finland is higher than from California to Maine. As CMU becomes a reality, the process of integrating post-trade infrastructure will need to keep pace.

However, at this point we believe it is necessary to adopt a long-term strategic approach to developing a better integrated post-trade infrastructure. Following the two Giovannini Reports (2001 and 2003) a number of important steps were taken to harmonise clearing and settlement arrangements. Broadly speaking, most of the "quick wins" harmonisation measures that can be delivered by the markets themselves, have been achieved. What is left are the more intractable problems that require public sector intervention. In addition, significant regulatory and structural changes are underway and it is too early to assess their impact. These include the introduction of the T2S settlement infrastructure, new legislation consisting of EMIR, CSDR, AIFMD and MIFID2 and prospective legislation on recovery and resolution of market infrastructures. For many of these regulatory initiatives the focus was risk reduction rather than market integration; indeed, in some respects they present barriers to competition and consequently consolidation (see examples below).

The most important long-term objective is to achieve more efficient and cost effective post-trade infrastructure in securities markets through the consolidation of infrastructure providers into a smaller number of institutions with the scale to drive efficiencies and provide a pan-European service but still generate competition. The structural changes underway will tend to drive in this direction, provided they are not blocked by protectionist moves. The public sector role should be to ensure that recent legislation is fully and consistently implemented and that these developments

are not blocked, if necessary by enrolling the support of competition policy. Opening up competition is the most likely route to consolidation.

In addition we see two areas of public policy that require further attention:

1. The first is to give issuers greater freedom in how and where they issue securities by opening up the links between country of incorporation, CSD of issuance and location of listing. The combination of T2S and CSDR is intended to give issuers greater freedom to choose where they issue securities, but listing rules and company law may still present obstacles. We suggest that the development of a "29th" company law regime be considered further to achieve this objective as an alternative to pursuing harmonisation of securities laws;
2. The second area relates to tax, in particular withholding tax on dividends and other income from investments. Proposals to harmonise the procedures for claiming exemption or refunds have been under discussion for some years. Implementing these proposals would significantly reduce the costs of cross-border investment across Europe.

Examples of barriers

- The MiFID II/MiFIR equivalence provisions for third country access to the EU – in particular the poor and inconsistent drafting of Art 39 MiFID II in conjunction with Art 46 and 47(3) MiFIR dealing with branch requirements and availability of branch passports following an equivalency determination and the equivalence determination requirements which are coupled with a reciprocity precondition in Art 47(1) MiFIR. Reciprocity requirements have no place in the global financial markets. They hamper equivalence determinations (in MiFID II making it very much more difficult ever to arrive at an equivalence decision for cross-border services) and consequently act as barriers to access for third country institutions in Europe and to third country products for European investors.
- Reciprocity and equivalence requirements in the Bank Structure Reform regulation proposal where non-EU subsidiaries of an institution subject to the rules would only be excluded from the EU rules where situated in an equivalent and reciprocal regime.
- EMIR equivalence requirements not taken forward – in relation to third country CCPs which adversely affects clearing activities in the EU and consequently mandatory clearing, and in relation to deferral to equivalent third country regimes for clearing, non-cleared derivative risk mitigation (including margin requirements) and intragroup exemptions from clearing and margin requirements.
- "Protections" given to derivatives CCPs under MiFIR that could delay or stop open access to some CCPs;
- Various references in MiFID to the use of listing market data as a reference point (e.g. tick size calculations; and dark book reference prices).

Delivering a Single Market in Capital for savers, investors and pensioners

Consultation questions:

11) What steps could be taken to reduce the costs to fund managers of setting up and marketing funds across the EU? What barriers are there to funds benefiting from economies of scale?

13) Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

17) How can cross border retail participation in UCITS be increased?

18) How can the ESAs further contribute to ensuring consumer and investor protection?

19) What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

24) In your view, are there areas where the single rulebook remains insufficiently developed?

25) Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?

Recommendations

- Consider whether a horizontal approach to the marketing of retail investment products is warranted.
- Consider whether legal obligations upon national competent authorities to ensure suitability and best execution are being properly discharged.
- Consider whether there is a level playing field for non-traditional platforms for the distribution of and guidance about investment products, including with respect to digital distribution.
- While a European pension system is unlikely to meet the subsidiarity test, more could be done at the European level to share best practice and encourage all Member States to move to a system of funded pensions.
- Some current regulations are at odds with the stated ambitions of CMU and hamper the ability of funds to divert private investment in long-term illiquid assets. For example, the prudential requirements in IORP II, Solvency II (standard model) and CRD IV currently penalise investment in infrastructure and other long-term projects. These should be revisited in light of the CMU.
- Encourage EU measures to reduce costs for setting up funds and marketing them across borders, in order to lower barriers to entry and create more competition. One way to do this would be through the incorporation of a marketing passport for third country AIFMs. A reduction in the scope for national gold-plating, e.g. requirements for paying agents, would also support this.
- When impact assessments and cost-benefit exercises are being conducted the individual costs associated with each piece of legislation should be examined alongside the cumulative cost of regulation as it affects a particular sector rather than simply being assessed on a stand-alone basis.

Introduction

European savers tend to deposit more money in banks compared to their U.S. counterparts, who hold relatively more of their savings in securities and investment products like pension schemes and life insurance.[28] Our ambition is that Member States move to a system of funded pensions and that families broaden their investment horizons with appropriate guidance and advice to achieve their lifestyle aspirations in retirement. It is well documented that diverse portfolios of assets offer higher risk-adjusted returns.[29] Given that bank deposits currently offer low or even negative real interest rates, now is an opportune moment to begin a process of cultural change in Europe.

Greater use of funded pension systems will expand the pool of capital available for investment and have positive knock-on effects for the sustainability of these systems. Government, employers and financial institutions all have a role in promoting financial education. Investor protection should be both robust and proportionate to the size and sophistication of investors. There are important areas where European institutions have a role to play in ensuring that European investors have a wide variety of choices for investment. Member States' gold-plating prevents the realisation of economies of scale across the Single Market.

As has already happened in so many other segments of the economy, digital platforms will revolutionise the marketing of (and guidance for) investment. Those buying financial products will ultimately benefit from concomitant improvements to the markets' attractiveness and productivity. Regulation should facilitate rather than hinder such innovation.

Investment patterns across Member States

Investment habits and systems for providing retirement income to citizens vary across Member States in many respects, including:

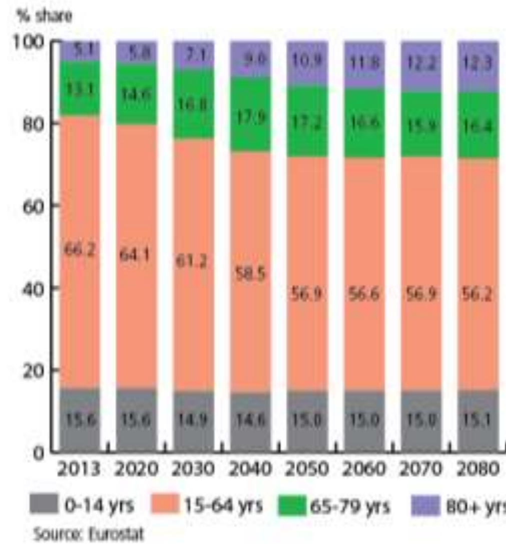
- the balance between private and public provision (under Pillars I, II and III)[30]
- preferences between bank deposits, life insurance, pension schemes and self-directed investment
- household saving rates (in 2014, the net saving rate of disposable household income was 11.9% in Sweden, 5.0% in Ireland, 1.6% in Poland and -0.2% in Denmark[31])

The environment of historically low interest rates, while helpful in stimulating current growth, poses problems now and in the future related to retirement provision. In Germany, for example, Bund yields are low compared to the European average while the guarantees on life insurance products (which are highly exposed to Bunds) are higher than the European average.[32] The eventual unwinding of today's unconventional monetary policy and the normalisation of interest rates is likely to pose other challenges, with potential market volatility for fixed-income securities anticipated by many market participants.

[28] Veron, N. and Wolff, G. *Capital Markets Union: a version for the long term.* Bruegel, 2015.
[29] See Markowitz, H., *Portfolio Selection.* Journal of Finance, 1952; Elton, E. J. and Gruber, M. J., *Modern Portfolio Theory and Investment Analysis*, 1981; and Berstein, W., *The Intelligent Asset Allocator*, 2000.
[30] Aviva, *Towards Annual Pension Statements Across The EU,* 2011.
[31] OECD, *Economic Outlook No. 95 (database)*, 2014.
[32] International Monetary Fund, *Germany: Selected Issues*, 2014.

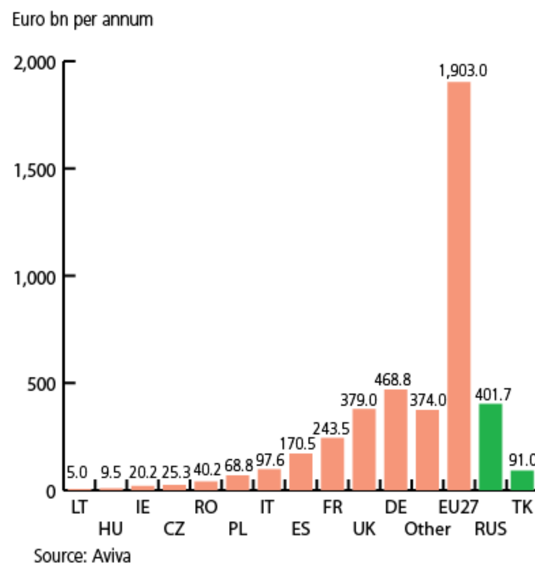
In terms of state provided pensions, the sustainability of 'pay-as-you-go' pension systems is set be compromised given European countries' increasing dependency ratios.[33] This is illustrated in the figure below:

Population Structure by Major Age Groups EU-28



Funded pension systems and higher savings rates (in some countries) will need to emerge in order to avoid unsustainable fiscal burdens on governments. These projected burdens are the result of the so-called pension gap: the difference between the required pension provision and the pension a retired person can currently expect to receive. Research by Aviva highlights the country-wide disparity in the pension gap:

Total EU Annual Pension Gap for Individuals Retiring 2011 - 2015



[33] European Commission, *The Ageing Report*, 2012.

Question 13

Increasing the pool of invested assets

Funded pensions

European policymakers face a significant challenge in ensuring that people have adequate pension savings to fund longer retirements. Some Member States have moved ahead with bold reforms to encourage saving at an earlier stage. In the UK, auto-enrolment – which automatically opts employees into pension schemes – began in 2012 and although at an early stage, has the potential to be a major step towards addressing under-saving in pensions. While a European pension system is unlikely to meet the subsidiarity test, more could be done at the European level to share best practice and encourage all Member States to move to a system of funded pensions.

The development of private pensions systems should be promoted and is essential to ensure long-term source of funding for the EU. The U.S. market holds 56.3% of all private pension assets across OECD countries[34] - that is USD22.7tn or 135% of US GDP in 2013. By contrast, private pension assets in Europe are alarmingly low (with the notable exceptions of the Netherlands, UK and Denmark). According to the OECD[35], in 2013, Italy held private pension assets of just 7.6% of GDP, with France at 9.6% and 13.3% for Spain.

Questions 10 & 18

Diversifying invested assets

Expanding the universe of long term investment opportunities will need to be accompanied by dialogue with industry and regulators on the suitability of products and accompanying investor protections, legal safe harbours and national compensation schemes. The European regulatory framework remains world-class in terms of investor protection. If increasing capital markets intermediation is to be accompanied by a corresponding increase in the allocation of individuals' savings from bank deposits to securities, it will be important to consider how well-equipped European savers and their advisers are to assess and account for the different types of risk involved, particularly in certain Member States with less developed markets for investment advice.

Questions 11 & 19

Improving outcomes for retail investors

There are too few channels for individuals and families to access affordable investment products and to receive guidance and advice on such investment. Greater choice between a wider variety of distribution channels would be of benefit to savers. Recent legislation should help to make information available to retail investors more relevant and intelligible. Advances in technology mean that digital channels will have an increasingly important role to play. It is important that these new channels have an opportunity to compete with traditional means of distribution on a level playing field.

There is currently a varied regulatory framework for marketing investment products to retail investors, with different obligations for life insurance providers, wealth managers

[34] OECD, *Pension Markets in Focus.* 2014.
[35] *ibid.*

and banks. The rules governing the distribution of retail investment products are widely divergent across Member States. It is likely that some of these rules lead to sub-optimal outcomes for investors and unduly restrict the cross-border provision of services. The European Commission should undertake a study looking at investor outcomes and the suitability of advice and guidance across products and distribution channels. Particular consideration should be given to the possibility of a horizontal regulation to address additional Member State requirements that inhibit cross-border investment and unduly incentivise particular forms of investment.

The IRSG supports EU measures to reduce costs for setting up funds and marketing them across borders, in order to lower barriers to entry and create more competition. One way to do this would be through the incorporation of a marketing passport for third country AIFMs. A reduction in the scope for national gold-plating, e.g. requirements for paying agents, would also support this.

Some current regulations are at odds with the stated ambitions of CMU and hamper the ability of funds to allocate private investment in long-term illiquid assets. For example, the prudential requirements in IORP II, Solvency II (standard model) and CRD IV currently penalise investment in infrastructure and other long-term projects. These should be evaluated in light of the CMU agenda.

Spotlight on better regulation and supervision

Financial services can work better for Europe’s consumers by unlocking the potential of the Single Market in Financial Services. The European Commission has indicated that policy development in this area will be a priority during the 2014-2019 mandate. Better regulation, supervision and revisiting the role of the ESAs will play an important role in furthering this agenda.

The years of the financial crisis saw the financial sector weakened in playing its full supporting role in the wider economy. The financial crisis also showed that consumer protection in some financial markets was inadequate or deficient. Numerous measures have been taken to remedy earlier shortcomings and much has been done to establish the regulatory framework necessary for a strong, stable and supportive financial system. The regulatory architecture needs to enable, rather than inhibit, growth by providing a seamless and effective conduit for capital to reach businesses which need it to grow. Flows of capital between the EU and other markets may be involved. Where this requires initiatives to establish regulatory coherence and cooperation between the EU and the markets in question, these initiatives should be undertaken, with a view to ensuring that regulatory divergences are identified and tackled before they disrupt markets.

Impact assessment, compliance cost assessment and cost-benefit analysis need to be central to the legislative and rule-making process. No legislation should go through the College of Commissioners, Council of Ministers or European Parliamentary Plenary without an adequate impact assessment having been published beforehand.

There are a number of institutional reforms which would help achieve this goal. Partly this relates to the quality of the resources devoted to policy-making and how they are organised. The IRSG suggests the following reforms:

- The new First Vice-President responsible for Better Regulation should undertake a fundamental review of the tests which need to be applied to any legislative or rule-making proposal and the resources devoted to this work. The better regulation agenda should be promoted more widely so that the benefits are recognised among the wider public.
- Member States need to commit themselves to equally sound better regulation processes, whether implementing EU legislation or devising their own.
- The Regulatory Scrutiny Board (formerly IAB) should be made an independent body accountable to the European Parliament. It should serve all EU institutions and scrutinise amendments by the Council and the Parliament.
- The main features of Better Regulation which require particular focus are proportionality and subsidiarity and regulation needs to be precisely targeted in both cases to ensure that unintended consequences are minimised.
- Post-implementation reviews should be agreed as a compulsory part of the rule-making process, as should the deadline by which regulation will be reviewed.
- When impact assessments and cost-benefit exercises are being conducted the individual costs associated with each piece of legislation should be examined alongside the cumulative cost of regulation as it affects a particular sector rather than simply being assessed on a stand-alone basis.
- Impact assessments can be made more 'user-friendly' to ensure proper dialogue. For example, it would be helpful to split impacts into those applicable to companies and those relevant to savers and investors.
- Improving the assessment of European proposals must also address how to best involve the ESAs.

More generally, the ESAs play an important role in protecting the integrity of the Single Market as they are tasked with promoting supervisory and regulatory convergence and ensuring that new structures, such as Banking Union, do not unintentionally fragment the Single Market. There should be a force not just for enhancing choice and competition, but also global competitiveness. Over the past six years, the ESAs have mainly focused on regaining financial stability through more regulation, with many measures still having to be implemented. The Commission has estimated that over 400 Delegated and Implementing Acts (e.g. relating to MiFID II, Solvency II, BRRD and CRD IV) remain to be adopted. The ESAs also work with the European Systemic Risk Board (ESRB) to ensure financial stability and to strengthen and enhance the EU supervisory framework. They aim to improve coordination between national supervisory authorities and raise standards of national supervision across the EU. The IRSG does not believe that the ESAs should be given more powers, but they should be empowered to make better use of their current mandate by:

- Focusing on the implications of how the ESAs perform their functions for jobs, growth and competitiveness and the integrity of the Single Market. Although Treaty protection is well-established, European legislation for financial services has recently begun to also protect explicitly the integrity of the Internal Market and emphasise the principle of non-discrimination. Provisions that ensure fair and equal treatment for all Member States should be incorporated where appropriate in all legislation going forward, as e.g. is the case in MiFID II.

- Playing a more prominent role in safeguarding the Single Market by using peer review to identify divergent application and interpretation of rules and enforcing the consistent application of rules through opinions and recommendations as set out in the Single Rulebook.
- Being involved better in consultations and impact assessments relevant to their legislative work. Their expertise should be made available to Level I decision-making by submitting an opinion on Level I proposals as the ECB does, with a particular focus on jobs and growth. The ESAs' involvement in the development of Commission Impact Assessments could be systematised, as well as in ex post assessments. More time should also be allocated to the ESAs to ensure effective consultation in relation to their Level 2 responsibilities.
- Being given easier access to data on the institutions they supervise and regulate by national regulators. This will enable them to interact more fully with stakeholders in the formulation of the Single Rulebook through improving their consultation processes, both in terms of timetable and transparency. The data should continue to be provided by national supervisors to avoid unnecessary duplication and cost to firms.
- By addressing concerns about the proliferation of multiple reporting requirements voiced by the industry. Data should continue to be provided by national supervisors to avoid unnecessary duplication and cost to firms.
- Working closely with the ECB and NCAs to counter a possible slowdown in supervisory convergence in the Single Market. This is especially relevant as supervisory practices will converge through the development of an SSM approach to banking supervision. The SSM Supervisory Manual will apply both to significant banks and to less significant banks. The EBA needs to ensure that banks in non-SSM Member States are being considered.
- Conducting a horizontal review of the outcomes for the consumers of financial services and products in the EU in cooperation with the European Commission. This review should be the first step of a larger programme of giving consumer and investor protection a higher priority in their work and promoting transparency and fairness. Being well and more independently resourced. The ESAs' insufficient resources have practical implications, as they lack the ability to implement their decisions, establish authority and fulfil effectively their consumer protection obligations. The inclusion of ESA funding as a separate line in the EU Budget is therefore desirable, and the ESAs should be subject to appropriate scrutiny and accountability mechanisms.

Finally, while we do not believe that the creation of a new EU Capital Markets Authority is the right approach; we note that the European Systemic Risk Board (ESRB) already performs a European-wide role in respect of macro-prudential supervision. It is well-placed to assist the ESAs and the NCAs in their oversight of European capital markets. A high burden of proof should be required to change institutional arrangements.

CMU is primarily about economic growth and not systemic risk. It provides an opportunity to recalibrate the ESRB's role. Firstly, its independence from the other authorities should be ensured. Secondly, the ESRB should be given a genuinely counter-cyclical mandate, to recommend tightening or relaxing prudential standards at the appropriate time. For example, the UK Financial Policy Committee has a primary objective of addressing the sources of systemic risk and a secondary objective of contributing to sustainable economic growth.

Long Term Finance for Infrastructure

Commission's consultation questions:

3) What support can be given to ELTIFs to encourage their take up?

4) Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?

5) What further measures could help to increase access to funding and channelling of funds to those who need them?

12) Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?

Recommendations

- There is no shortage of money to finance infrastructure projects, but more 'shovel-ready' projects are required in the pipeline.
- The European Commission's Investment Plan acknowledges the need to improve access to financing for infrastructure and the role that capital markets can play to address the intermediation gap between the supply and demand for long-term financing. The European Commission should continue to allocate sufficient resources to the implementation of this project.
- Political and economic uncertainty in the EU partially explains why long-term investment is lagging even though there is liquidity in the market. While the IRSG acknowledges that regulatory certainty on a national level is beyond the remit of European institutions, European activity, i.e. the forthcoming EIOPA investigation into insurance investment in infrastructure projects, also creates uncertainty among investors which needs to be managed better.
- Consideration should be given to a more proportionate and risk-sensitive prudential treatment for institutional investors, including the calibration of Solvency II and IORP II.
- Asset frameworks need to be revisited so as to allow banks, insurers, pension funds and UCITS funds to invest in ELTIFs.
- Openness to investors and providers from outside of the EU is crucial as Europe competes with the rest of the world to attract long-term investment.
- The IRSG supports and calls for the consistent and effective enforcement of the principles identified by the OECD to favour macroeconomic conditions that are conducive to longer-term investment.[36]
- The cooperation between private and public sector investors needs be improved and expanded.

[36] OECD, *G20/OECD High-level principles of long-term investment financing by institutional investors*, September 2013,

Introduction

The case for additional investment in infrastructure in Europe is widely acknowledged. The European Commission estimated in 2011 that infrastructure investment needs up to 2020 were in the range of €1.5–2 trillion.[37] The IRSG estimates that infrastructure investment needs worldwide over the next 15 years will reach nearly €60 trillion.[38]

The availability of private investment for European infrastructure projects has been strongly affected by the financial crisis. The present economic environment, which is characterised by risk aversion and uncertainty, has limited the ability of private investors to profit from long-term investment projects. The OECD G20/OECD High-Level Principles of Long-term Investment financing by Institutional Investors cites low interest rates and uncertainty over future growth prospects and policy developments as the main issues hindering the willingness of institutional investors to invest in the long-term. The report adds that the ageing population may have also reduced the risk appetite and time horizon of investors. In an environment where public balance sheets are also restrained, neither the public nor the private sector alone has the capacity to deliver what is needed. Only by working in partnership across the whole of the EU can a challenge on this scale be met.

Governments have a central role as catalyst for projects as well as setting the associated policy framework. The private sector will be involved in different ways in executing these projects, including in some cases through financial and related professional services. Investors will be required to fund many of these projects and take on attendant risks. In terms of the treatment of infrastructure investment in the financial regulatory framework, illiquid assets should not be unduly penalised, particularly when they represent natural partners for pensions and life insurance funds. Delivering investment and services required for the needed scale of infrastructure development will require openness to investors and providers from outside of the EU. Funded pension systems can also help to mobilise capital for long term investment.

Infrastructure needs

Infrastructure is both a shared long-term investment and an intergenerational legacy. Investment strategies and policies can be considered fair and sustainable if they satisfy present needs without compromising the ability of future generations to meet their own needs. Conservative estimates of the impact of new prudential capital and liquidity rules for banks in Europe indicate a minimum of €4 trillion gap in funding for the economy in the 5 years to 2020. The Commission's plan for a Digital Single Market in Europe identifies the roll-out of broadband infrastructure as a crucial component in maximising the growth potential of the digital economy and creating the conditions for innovative services to flourish.[39] An estimated €93 billion of investment in broadband infrastructure will be required to meet the targets set out in this strategy.[40] Meeting the goals associated with Energy Union are estimated to require €200 billion of investment annually over the next decade.[41] Cross-border European transport infrastructure is estimated to require €700 billion in investment to 2030.[42]

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[37] European Commission, *Europe 2020: A strategy for smart, sustainable and inclusive growth,* 2010.
[38] IRSG, *Long-Term Finance for Infrastructure and Growth Companies in Europe*, 2015.
[39] European Commission, *A Digital Single Market Strategy for Europe*, 2015.
[40] European Commission, *A Digital Single Market Strategy for Europe - Analysis and Evidence,* 2015.
[41] European Commission. *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy,* 2015
[42] European Commission, *Commission identifies the infrastructure priorities and investment needs for the Trans-European Transport Network until 2030*, 2015.

Policy risk as a barrier to investment

Infrastructure projects face considerable future risks and uncertainties. The financing of infrastructure projects is subject to selection risk, planning risk, procurement and contract design risk, construction risk, asset operation and longevity risk, and political risk. Of these, planning and political risks are most notably beyond the control of the private sector and political risk is predominant. This risk is also reflected in ratings of infrastructure debt and is an important factor in determining financing costs. It is only when the public and private sector work in partnership that these risks can be properly managed in a way that unlocks the finance necessary for infrastructure construction and renewal. By working in partnership, the public and private sectors can deliver a pipeline of strategically significant infrastructure projects that enable the creation of jobs and growth in the broader economy. Only governments can give the long-term certainty throughout the life of a project that makes political and planning risk acceptable to investors. By the transparency, predictability and certainty of planning, procurement and policymaking, governments can fulfil the public sector's ambitions for infrastructure in partnership with private finance. By depoliticising big infrastructure projects, e.g. through their inclusion in national infrastructure plans, the political risk would be decreased and easier to assess.

However, delivery is just as important. This partly comes down to having the right well-qualified experts in place with authority to implement the plan. For projects to be carried out quickly and efficiently it is essential that Governments employ experts who understand private sector drivers (including appropriate risk allocation) and can perform consistently over successive projects.

Question 10

Liquidity requirements

Europe's ageing population requires long-term investments that match the long-term need for an income in retirement. Long-term investment choices should be made by entities committed to long-term horizons. This requires ongoing cooperation between the financial services industry, public sector partners and policymakers in order to design and promote new funding models and to provide investors and corporates with the confidence to commit substantial funds to a project over a long period of time. Entities committed to long-term horizons such as pension providers are natural potential investors for long-term infrastructure projects. Pension providers need to invest in diversified assets including infrastructure as well as in bonds and equities in order to guarantee stable returns over the long-term. Investment in illiquid asset classes can be difficult, especially when individuals have the option to switch funds easily. In Australia and Canada, investment and pensions regulation allows pension funds to invest in illiquid assets to a higher degree than in most other countries[43]. EIOPA can support more proportionate and risk-sensitive prudential treatment for institutional investors. If Europe's insurers are able to reduce the amount of capital they hold against high quality securities they will be better placed to invest in Europe's infrastructure. Proposals in the Delegated Act cover securities guaranteed by the European Investment Fund or European Investment Bank as well as investments in closed-ended, unleveraged investment funds, including specialist infrastructure funds. It is important to review whether this scope is appropriate and if there is a need to expand it further.

[43] *Ibid.*

Question 3 **European Long Term Investment Funds**

ELTIFs should be considered as a complement to existing fund vehicles such as UCITS, AIFM and special purpose vehicles. As it currently stands, the illiquid nature of ELTIFs are likely for to make them unsuitable for direct retail investment. However, it is important that end investors are able to access illiquid investments through other investment products. As such, consideration should be given to how changes can be made to prudential or eligible asset frameworks such that banks, insurers, pension funds and UCITS funds can invest in ELTIFs. For ELTIFs and more generally, consideration should be given to the appropriateness of calibrations for long term investment in Solvency II and IORP II.
To support the success of the ELTIF as an effective cross-border investment vehicle, barriers should be addressed at the Member State level which favour bank based investors over capital markets investors, such as withholding tax on loans or preference given to banks during insolvency proceedings through a 29th regime 'asset passport'[44].

Question 5 *Macroeconomic conditions favouring long-term investment*

Capital markets can facilitate the allocation of finance for infrastructure that enables economic productivity and employment growth. There is no shortage of money to finance infrastructure, but there are obstacles in the way of the efficient allocation of capital to infrastructure projects. The IRSG supports and calls for the consistent and effective enforcement of the principles[45] identified by the OECD to favour macroeconomic conditions that are conducive to longer-term investment. Amongst others:

- The OECD calls for policy coherence from international, national and subnational authorities to help achieve broader policy goals such as financial stability, debt sustainability, jobs and growth. This policy coherence is particularly important regarding credible monetary policy frameworks, responsible fiscal policies and appropriate and predictable regulatory and supervisory framework within and across jurisdictions. Tax neutrality towards different forms and structures of financing should be promoted. The tax environment should as far as possible be made consistent and stable across countries to facilitate the cross-border flow of long-term financing.
- In order to support the development of long-term savings and to increase awareness amongst the population, governments should promote savings mobilisation policies, appropriate financial incentives, financial literacy and the removal of tax impediments.
- Regulatory and supervisory authorities should, where appropriate, provide guidance to institutional investors regarding the governance and risk management requirements to meet long-term investment objectives.
- Long-term assets have particular risk characteristics which should be fairly reflected in solvency, accounting and funding requirements, to avoid creating incentives for procyclical investment strategies. As the OECD states, "Excessive

[44] Blackrock, *The European Capital Markets Union: An Investor Perspective*, February 2015.
[45] OECD, *G20/OECD High-level principles of long-term investment financing by institutional investors*, September 2013.

or mechanistic reliance on external investment or creditworthiness analysis (such as credit rating agency ratings) should be avoided".

- Public support for long-term investment and financing vehicles should be decided on the basis of identified market failures, should avoid crowding-out private investments, and should be selected by carrying out appropriate cost-benefit analysis of such interventions.
- Barriers to international investment by institutional investors should be removed when appropriate, especially when targeted to long-term investment.
- Data collection and information sharing on long-term investments following standardised classifications should be promoted at both the national and international level, to facilitate monitoring by supervisors, enhance the knowledge of institutional investors, reduce information asymmetries and improve the functioning and liquidity of markets.
- An appropriate consumer protection framework should be combined with tailored financial education for the actual users of institutional investment vehicles, to raise awareness about the potential benefits, risks and costs of long-term saving and investing.
- Where initiatives are required to establish regulatory coherence and cooperation between the EU and other financial markets, these initiatives should be undertaken, with a view to ensuring that regulatory divergences are identified and tackled before they disrupt markets.

Question 10 **Public-Private cooperation**

A number of channels are being developed through which long-term investment can be facilitated with both public and private participation. The European Investment Bank (EIB) and its Project Bond is an example of risk sharing support provided by state entities to facilitate investment in particular projects. The Project Bond pilot stage began in 2012 with two main objectives; stimulating investment in EU infrastructure and establishing debt capital markets as an additional source of financing. The programme consists of the EIB providing financial assistance that enhances the credit quality of bonds in target projects identified by the European Commission. This can help guarantee early stage investment from the private sector that might otherwise be considered too risky. However, the EIB should also be mindful not to crowd out private investment.

At present, such projects are limited to the EU Connecting Europe Facility which seeks to develop Europe's energy, transport and digital infrastructure. The European Commission's Communication on long-term financing contained a recommendation to explore expanding the use of Project Bonds beyond the Connecting Europe Facility, a proposal the IRSG is supportive of.

Public Private Partnerships (PPPs) provide an increasingly popular channel through which public and private partners work together to deliver certain investment projects. PPPs are important for long-term infrastructure financing where the stability of a future income stream is not always clear. The European Commission's Communication on long-term financing includes an action to improve the availability of transparent information and data on new PPP projects, an ambition the IRSG supports.

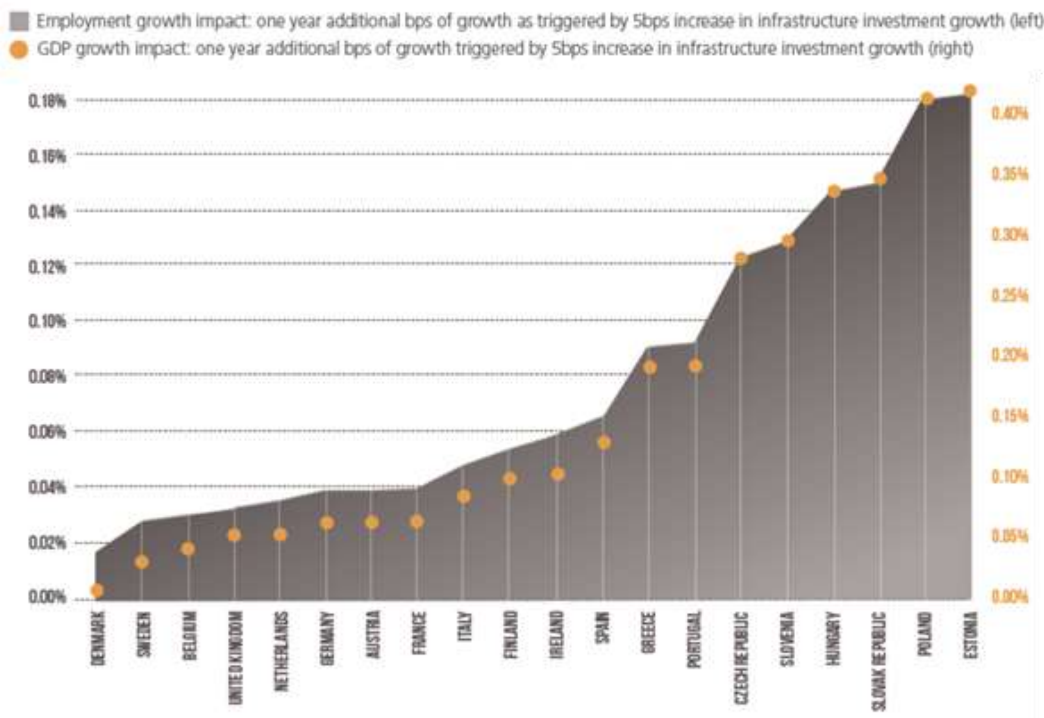
The cooperation between private and public sector investors could be improved and expanded through the use of innovative tools:

- Where appropriate, governments should provide opportunities for private sector participation in long-term investment projects via, for instance, public procurement and public-private partnerships;
- There should be more public support measures to improve accessibility for infrastructure financing (i.e. credit enhancement, guarantee programmes, role of MDBs);
- The number of national projects eligible for Project Bonds Credit Enhancement (PBCE) should be increased in order to develop investor appetite for infrastructure assets.

Broader impact on jobs and growth

Investment choices in infrastructure and growth companies are of significant importance for the broader economy. Investment decisions should be strategic, addressing both the short-term risk and reward profiles of participants as well as longer-term policy goals. TheCityUK and Accenture created an econometric model to quantify the impact on output and employment of an increase in infrastructure investment in the EU. The analysis included in the IRSG's recent report *Long-Term Finance for Infrastructure and Growth Companies in Europe* demonstrates on average, the impact on growth is larger than the impact on employment: across the 20 countries studied, the average change in employment growth relative to the baseline forecast is 0.08 percentage points, whereas the average change in the output growth is 0.2 percentage points.

Cross-Country Impact of Infrastructure Investment



Spotlight on policy coherence – CMU/Energy Union

CMU has the opportunity to enhance the deliverability of other Commission priorities, including Energy Union. It will be crucial to ensure coherence between these priorities and particularly to avoid financial regulation working at cross-purposes with the development of energy infrastructure.

On 25 February 2015, the European Commission adopted a Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy (the Framework). The purpose of the Framework is to outline the Commission's vision of an Energy Union - one of the key priorities of President Juncker's political guidelines - and the main actions that have to be taken in the next few years to achieve this goal.

The EU is the largest energy importer in the world, more than half of its energy being imported at an annual cost in excess of €400 billion. It is estimated that more than €1 trillion will need to be invested into EU's energy sector the next five years alone.

The European energy sector is currently facing a number of challenges. Although the EU has energy rules set at the European level, in practice, it has 28 national regulatory frameworks. Further, the retail market is not functioning properly and many household consumers have too little choice of energy suppliers. On top of this, energy infrastructure is ageing and the building of new infrastructure, more adjusted to the increased production from renewables, requires substantial long-term investments.

As highlighted by the OECD, there are myriad investment channels for sustainable energy that hold potential to attract institutional investment and to lower the cost of capital for sustainable energy[46]. So far, there have been a number of initiatives to promote and incentivise investment in energy infrastructure: Projects of Common Interest (PCIs), including the Connecting Europe Facility (CEF), EU Cohesion Policy Funds, the EIB's Project Bond Initiative, the European Energy Programme for Recovery, EFSI and financing under the European Structural and Investment Fund, pooling resources to finance economically viable investments that counter market distortion and fragmentation. The Energy Union is intended to bring cohesion to the existing financing schemes – connecting the dots – to maximise impact.

The Investment Portal, which is being set up in conjunction with the European Fund for Strategic Investment (EFSI), is intended to give investors access to information about the investment pipeline. Infrastructure investors are very diverse in terms of target returns, investment policy, geographies and risk appetite. Some look to more traditional project finance structures where the available funding means can be useful, while others look to invest in or acquire TSOs, thereby investing indirectly in PCIs.

Neither the CMU nor the Energy Union can be approached in isolation. The success of the Energy Union is dependent on the financing made available, both publicly and privately. Ultimately, only properly integrated European capital markets will bring the required funding across EU for the Energy Union.

[46] OECD, *Mapping Channels to Mobilise Institutional Investment in Sustainable Energy*, January 2015.

Openness and regulatory coherence

Consultation Questions:

21) Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

22) What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?

Recommendations

- Introducing US dollar tranches in debt facilities would boost liquidity by attracting stable and strong US institutional investors. The US private debt market, in particular, has proven its ability to accommodate complex EU infrastructure transactions.
- Non-EU investors can provide Euro funding but they need to protect their currency position. Although that protection does not typically impact EU borrowers, it may provide expensive to unwind in the event of early repayment of a transaction. In such cases; international investors need to be made whole on currency swaps associated with the remaining life of the instrument, through a "Swap breakage" clause.
- An extension of the marketing passport to both non-EU AIFMs and non-EU AIFs would have a positive impact on competition and choice within the EU internal market for EU professional investors[47].

Introduction

The advantages of open international trade and investment are clear. Investors benefit from the possibility of investment in a worldwide range of assets, facilitated through transactions with non-EU service providers. Corporates benefit from the possibility of tapping a worldwide pool of investors for capital, potentially in multiple currencies. End users benefit from competition from worldwide providers, raising standards within the EU and making the Union more competitive.

Agreements to promote international regulatory coherence have so far failed to deliver the promise of what could be achieved. The EU should spearhead a renewed focus at the G20 level to ensure that post crisis reforms are implemented in a way that avoids fragmenting markets. The inclusion of financial regulatory coherence as part of the Transatlantic Trade and Investment Partnership would be an important step towards convergence between what are, at present, the world's two largest financial markets.

At the EU level, a new approach to third country recognition is needed. Equivalence assessments must be outcome based and proportionate; any new approach should be no less liberal than the current arrangements if it is to deliver an open and competitive Europe.

International regulatory coherence

[47] BlackRock, *Response to the Call for Evidence – AIFMD passport and third country AIFMs,* 2015.

Financial markets are global in nature and regulatory divergence, therefore, carries a variety of costs. It enables regulatory arbitrage that can undermine the effectiveness and stability of the global financial system and introduces duplicative or inefficient practices for both providers and users of capital. Therefore, effective cross-border regulation should be seen as a complement to preserving financial stability and maintaining high standards of investor protection and market integrity. Restoring trust between regulators is crucial to prevent disruption to cross-border capital flows and fragmentation of global markets. Extra-territoriality in regulation should be avoided.

Key challenges remain, typified by, but not confined to, transatlantic regulation. These include regulatory divergence, carrying various costs:

- extraterritoriality and conflicts of law, with compliance costs and uncertainties
- regulatory arbitrage
- damage to the effectiveness and stability of the global financial system
- threats to the ability of leading financial authorities to export regulatory approaches and best practices to rest of the world
- duplicative and inefficient practices for providers and users of capital, undermining growth

Newly salient regulatory divergences have also highlighted the importance of questions of process and transparency, and how these may hamper regulatory cooperation. Chief amongst these are:

- different administrative and political rule-making processes
- different timescales for making regulations, resulting in a sector or activity being regulated in one jurisdiction and not in another
- associated problems of transparency at different legislative and rule-making stages, with differing types of “notice and comment” procedures

The same problems affect data-movement, data-processing and data-sharing. A global solution focused on mutual recognition needs to be agreed at the governmental level to address these questions based on today’s realities, rather than yesterday’s paradigms. The Internet has become an important trade route for the 21st Century, but there is a rising threat of “digital protectionism”. Any international agreements should create rules to enable the cross-border flow of data to support trade and investment, while protecting personal data. Agreements of this nature take time to negotiate and can establish rules that are in place for decades, so they need to be “future proof”. Where trade agreements include provisions for the fundamental freedom of cross-border data movement, they must be fit for purpose if they are to gain business support and remain relevant for the global digital economy.

The United States and European Union should lead an effort to reenergize the G20 as the pre-eminent global forum on financial reform and call for a reaffirmation of this commitment at the next leaders’ summit. Since the 2009 G20 summit in Pittsburgh, the leaders’ summits have focused more on macroeconomic policy rather than market regulation and supervision, much of which has been left to the FSB. But with the risk of significant divergence growing, it is now time for the leaders to re-engage and tackle the hard political questions.

Third countries

EU and third country businesses interact daily through the capital markets in many different and sometimes complex ways. These activities are fundamental to funding and managing the real economy. They impact on capital raising by Governments and corporates, and on pension and

savings provision in the EU, and they give business opportunities and employment to many EU firms engaged in investment, banking, financial advisory and professional services. EU investment managers need to be able to invest freely in financial instruments in all third country markets in order to deliver diversified long term value for EU investors. To be able to do this, they routinely use affiliates, custodians, brokers and asset managers in those third countries to provide them with required services ranging from advice, through execution, to safekeeping.

EU investors, companies, investment managers, and broker dealers also rely on third country firms to provide research and other information about investment opportunities and local market conditions, to enable them to make timely and informed investment decisions. Large EU companies need to access investors worldwide for initial public offerings and debt issuance. They use third country investment banks to manage and advise in key third country markets. Indeed some third country regulators (for example Hong Kong) may require the use of a local firm. These third country firms may be acting as a service-provider to the EU companies. Restricting EU companies' access to them could hinder the ability of EU business to source low-cost of capital which in turn could detrimentally affect EU investment, jobs and growth.

Unfortunately, the regime governing third countries has proven to be unfit for purpose and this imposition of extraterritorial legislation over recent years has increased considerably. As a part of the Commission's cumulative impact assessment of post-crisis regulatory reform, a rigorous and impartial study of third country regimes across the legislative framework should be undertaken. The extraterritorial nature of much European financial services regulation must be examined and better managed. The results of this study should be the basis for beginning a political dialogue aimed at reshaping the European Union's approach to third countries and achieving international regulatory coherence in financial services.

Recognition assessments are a lengthy process. When the number of relevant jurisdictions involved is limited, in the case of CCPs for example, this is manageable. But in the case of investment firms, where there are potentially a great number of jurisdictions involved, long transition periods and satisfactory transitional measures are needed. It is therefore necessary to also develop a toolbox of transitional measures to ensure that there continues to be cross-border access in the intervening period.

Links between EU businesses and third country service-providers of all kinds are complex and not easy to classify into a limited range of defined transactional relationships. EU regulation must therefore cater flexibly for a mix of relationships with third-country providers that is unpredictable and subject to future development as EU businesses' global relationships expand.

Questions 21 & 22 *TTIP*

A key priority should be a process in the TTIP for identifying, tackling, managing and preferably removing such obstacles in ways satisfactory to both sides, thereby securing improved regulatory coherence between the EU and the US. Gaining such coherence should not rely only on solving regulatory downstream spill-overs ex post: it should also encompass upstream or ex ante processes for anticipating difficulties and working together on them before they arise.

Question 22 **Facilitating inward and outward investment**

Opportunities for investment in high growth markets

For pension funds to continue to deliver the best returns for investors, access to high growth markets across the world is especially important. In some of the markets, businesses or infrastructure projects may struggle to raise funds domestically. Access to global investment markets can increase growth prospects for businesses or the development of important domestic infrastructure. Maintaining access between the EU and global markets is therefore important, both for maximising investment opportunities for European investors and the broader growth and development prospects in recipient markets. Where this involves initiatives to establish regulatory coherence and cooperation between the EU and the markets in question, these initiatives should be undertaken, with a view to ensuring that regulatory divergences are identified and tackled before they disrupt markets.

Questions 21

Attracting international capital

In order to attract non-EU capital to invest, particularly in infrastructure and project finance, non-EU capital must be able to compete on a level playing field with EU funds in state-sponsored procurement processes. The following may help in this regard:

- Introducing US dollar tranches in debt facilities would boost liquidity by attracting stable and strong US institutional investors. The US private debt market, in particular, has proven its ability to accommodate complex EU infrastructure transactions.

- Non-EU investors can provide Euro funding but they need to protect their currency position. Although that protection does not typically impact EU borrowers, it may provide expensive to unwind in the event of early repayment of a transaction. In such cases; international investors need to be made whole on currency swaps associated with the remaining life of the instrument, through a “Swap breakage” clause.

The Commission should also be mindful of the fact that a number of its legislative initiatives may dampen the appetite of such firms to invest in Europe, due to the presence of overly restrictive third-country provisions or extra-territorial reach of a number of key European directives and regulations. The EU’s approach to third-countries in the area of financial regulation appears to be driven by the need to strengthen investor protection in the post-financial crisis economic environment. This understandable yet overly cautious approach to policy making is likely to deter the providers of long-investment from financing a European economic recovery. The Commission should consider reviewing its approach in this area, focusing instead on the objectives and principles of third-country regulatory regimes.

An extension of the marketing passport to both non-EU AIFMs and non-EU AIFs would have a positive impact on competition and choice within the EU internal market for EU professional investors[48].

[48] BlackRock, *Response to the Call for Evidence – AIFMD passport and third country AIFMs*, 2015.

Technology and Innovation

Consultation questions:

9) Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

31) How can the EU best support the development by the market of new technologies and business models, to the benefit of integrated and efficient capital markets?

Recommendations

- The IRSG supports the implementation of a 'digital investment passport', which would securely hold savers' administrative information and make investment advice and guidance more easily accessible for a broader segment of savers.
- The proposed EU Data Protection Directive and Regulation are important in setting standards for data protection, but it is essential to consider the broader realities of data in the world today in the context of mobile, cloud and internet.
- The European Commission and ESAs should collaborate on an initiative to facilitate discussion between firms and authorities about how new technologies and distribution channels can be developed.

Introduction

Increasingly, technology is changing the traditional models of intermediation, including through new platforms for retail investors and SMEs, for instance in the areas of payments, fund platforms, supply chain finance, peer-to-peer lending and crowdfunding. It will be important for a CMU to allow for innovative and efficient financial markets that can enhance consumer choice while ensuring investor protection.

A balance needs to be achieved between the benefits of general access to and use of data and personal data protection. Too much of one or the other will have significant adverse effects on economic development and personal protection.

A supportive legislative environment guides businesses and development on "what" to do, but refrains from being explicit on "how" to achieve this, to enable the fostering of innovative and customer focussed solutions, providing a springboard for development, rather than a checklist for compliance.

Questions 31

Financial technology

Technology and its benefits for consumers

Financial services and technology are inextricably linked. Everything from trading platforms to payment systems to online banking depends on the use of information technology. Over the coming years, the internet will increasingly become the foremost platform for consumers to make financial transactions. The capital markets framework should allow for consumers of financial services to enjoy the benefits of innovation

(whether that it is more immediate or timely access to markets and services, new and/or direct access to services and products) and consequent efficiency gains.

Digital technologies enable the emergence of alternative sources of financing, including through the development of social platforms for crowdfunding or peer-to-peer lending. They also provide an additional channel for new lending providers and ease the development of digitizing application processes for traditional financial institutions to offer new innovative financial services. Furthermore, new technologies also act as catalysts to foster the emergence of innovative financial services and enable transformation and efficiency within the traditional financial industry.

Digital technologies are also a significant area of support and innovation of analytical tools which play an important part in reaching customers and managing risks. Digital platforms themselves facilitate further innovation, see for example the development of applications across finance and other sectors as a consequence of 'App Store' platforms. The European Commission should fully assess the opportunity and impact of digital technologies to deliver CMU, with the consequent reduction to or amendment of regulation to facilitate innovation. Particular consideration should be given to how technology can facilitate guidance and advice. In the UK, a digital passport is currently developed as part of the Savings and Investments Policy (TSIP) Project which would securely hold savers' administrative information. Setting up a new savings or investment account can be a long process. The IRSG therefore supports the implementation of a 'digital investment passport' to accelerate the process of opening savings and investment accounts and to enable consumers to manage their finances online and in one place. A prototype of this 'digital investment passport', through which all of a consumer's financial information can be accessed, will be built in the coming months. It is hoped that a pilot programme will be launched in 2016. If successful, this initiative should be replicated in all Member States.

If Europe is to remain competitive on a global stage, it needs to harness the economic transformations and disruptions caused by the growth of the digital economy. Companies in general and those in innovative sectors in particular suffer from the current fragmentation of the Digital Single Market (DSM). It is estimated that Europe could gain 4% GDP by stimulating development of DSM by 2020.

Question 9 *Disintermediation and 'social' platforms*

Technology is changing the traditional models of intermediation, including through new platforms for retail investors and SMEs, for instance in the areas of payments, fund platforms, supply chain finance, peer-to-peer lending and crowdfunding. These in turn provide new, and wider access to financial services and products, particularly to SMEs and consumers.

Web based peer-to-peer platforms are growing quickly but remain small in volume terms. A key problem remains for investor protection and determine suitability: is risky lending suitable for some investors and not for others? How can such distinctions be made and enforced? A further question is whether exchanges or platforms that facilitate retail lending should be required to conduct a 'vetting' process with regard to the companies

that borrow money through their platforms. This would provide a level of protection to the lenders on the 'other side' of the platform.

The IRSG believes that this new technology should have a chance to innovative and develop before they are subject to the same regulatory requirements of traditional models of financial intermediation. As these platforms germinate, Member States will be best placed to observe their impact and respond to conditions in national markets. Should these platforms develop scale and begin greater cross-border activity, a European approach may be eventually be required.

Data Protection

The world continues to swiftly evolve, and we currently live in the digital information age. The unprecedented availability of information as a result of being in digital form is transforming how data is handled, what it is used for, and how it is protected. Fundamentally, a balance needs to be achieved between the freedom of general data use and personal data protection. Too much of one or the other will have significant adverse effects on economic development and personal protections. The growth agenda needs to be supported and nurtured, and a balanced approach to data legislation is key to achieving this. A focus on data localisation, whether at a country or regional level, is an inhibitor to growth and innovation, and creates barriers to many legitimate data processing measures, particularly in the context of data security, and the prevention and detection of crime.

The proposed EU Data Protection Directive and Regulation are important in setting standards for data protection, but it is essential to consider the broader realities of data in the world today in the context of mobile, cloud, internet etc. How the EU reacts to the realities of the digital age helps to set the international profile on these important issues, and changes which may appear to be small or incremental at the EU level, may have significant impact or consequences, including unintended consequences, at the international level.

The internet, mobile technologies and the phenomenon of globalisation facilitates the provision of goods and services in ways that were not contemplated a few decades ago, enabling new businesses to flourish online, opening opportunities for existing businesses of all sizes (down to micro-businesses) to reach new customers and evolve and grow, enabling participation in global supply chains, and opening new opportunities for competitive pricing.

Data analytics create opportunities for growth, innovation and job creation through new and smarter ways of doing business and connecting people. Appropriate technical and organisational measures are integral to safeguarding data in a fast evolving environment, and one where customers continue to demand individualised online services and are increasingly technically savvy across all generations, as well as demonstrating increasing awareness and exercise of their privacy rights.

A key aspect to developing trust in this evolving environment is to provide a framework and allow customers to select providers who meet their expectations and earn their trust,

rather than mandating proscriptive requirements which may adversely impact technological development.

Given these opportunities, it is inconsistent to encourage global investment and franchise expansion on the one hand, and to restrict data-flows, require localisation of data-processing and inhibit compliance with requirements of foreign jurisdictions, on the other.

Question 31

Partnerships between industry and government to facilitate innovation

Changes to technology and policy go hand in hand. The danger in seeking to 'future proof' legislation is unwittingly stemming the tide of innovation with overly proscriptive regulation. Rather it is important that policymakers take account of technological changes as they occur. One way the governments in the US (the so-called 'regulatory sandbox') and UK (the Financial Conduct Authority's 'Innovation Hub') have sought to do this is through the facilitation of a dialogue between the private sector and regulators about the regulatory treatment of new technology. There is the potential for such an approach at the European level.

Data capture and standardisation

The capital markets industry has used data standards such as common security identifiers. Additional similar steps could be taken to provide for a more rapid build-out of a CMU. Examples would be the full take-up of the Legal Entity Identifier (LEI) used to capture complex legal entity hierarchies, and perhaps the creation of standard instrument reference data repositories that today are highly fragmented across banks, custodians and other capital markets infrastructure players. With the adoption of more standardized means of dissemination of financial information, such as HTML5 for reporting, or an electronic repository of filings such as the US based EDGAR system, investors would find it easier and be more confident in deepening their participation in alternative investments, and SMEs would find it less arduous to evaluate their opportunities in raising funds in this market.