IRSG RESPONSE TO ROADMAP ON CAPITAL MARKETS UNION ACTION PLAN

The International Regulatory Strategy Group (IRSG) is pleased to respond to the European Commission's consultation on the roadmap to the Capital Markets Union Action Plan.

The IRSG is a practitioner-led body of leading UK-based representatives from the financial and professional services industry. It is an advisory body to the City of London Corporation, and to TheCityUK. The IRSG develops its policy positions through a number of workstreams which comprise representatives from across the industry to ensure a cross-sectoral response.

The IRSG welcomes the Final Report of the European Commission's High-Level Forum, and supports the efforts to re-make the case for the Capital Markets Union (CMU). The IRSG understands that there is no single silver bullet which will lead to a fully functioning CMU, and that change in some areas will take time, not least as an equity culture is not developed overnight. In commenting, the IRSG intends to share cross-sectoral experience from the UK and internationally.

This response groups its recommendations by the titles of the chapters in the HLF Report.

CONTENTS

The IRSG's key recommendations are:

- Overall, the IRSG supports the development of capital markets in Europe, particularly as they can be used to support shared policy objectives including supporting the green transition and the recapitalisation of the economy post-COVID 19.
- The IRSG welcomes the focus on improving citizen's participation in capital markets, through tools such as auto-enrolment and open finance. The UK has some experience in implementing such reforms, and to extent this would be constructive, we are happy to share our experience of this.
- The IRSG welcomes moves to improve market infrastructure, including the creation of a European EDGAR and consolidated tape. We are disappointed that the Forum did not include a proposal for a review of the CSDR settlement discipline regime.
- The IRSG believes the proposals for the CMU need to be underpinned with strong political commitment in order to advance the project.

OVERALL SUPPORT FOR DEEP, OPEN, INTERCONNECTED AND INTERNATIONALLY-ALIGNED CMU

The IRSG believes **that building deeper, better-connected capital markets in Europe can help achieve a number of policy objectives**. Growing capital markets in Europe will promote investment, help to realise the goal of a true single market for capital, and help European savers and companies realise their long-term financial objectives.

The aim of CMU should be to make the EU economy stronger, more resilient and more dynamic, and the report highlights the vital role that capital markets - particularly equity markets and risk capital - can play in supporting the **realisation of shared policy goals.**

Given that an increasingly number of investors have particular concerns around the environmental, social, and governance elements (ESG) of potential investments, the IRSG believes that the development of the CMU can help to attain sustainable growth across the EU and **support the transition to a greener and fairer society.**

The IRSG stresses the need for an open, **internationally-aligned CMU with a legislative and regulatory framework which allows EU companies and citizens to benefit from capital and expertise from elsewhere in the world outside the EU**, within a full competitive environment. In this way, EU investors will be able to access liquidity pools and have broader range of investment opportunities.

The CMU should **commit the EU to be the outstanding example of an open economy, with high standards but open to global investment, at a time when retrenchment and de-globalisation are taking hold across the world.** It is this policy approach that best serves Europeans and provides the best chances to achieve security in long term savings and retirement well into the future.

CMU IN THE CONTEXT OF COVID-19

The importance of effective capital markets that work for all - for the future financial well-being of European citizens and for the growth and development of EU companies and economies - has been recognised for some time, but is **more urgent than ever due to the ongoing COVID-19 crisis**. In addition to its negative effect on the European economy, the outbreak has had a serious impact on the personal financial health of European citizens. It is therefore vital that the CMU develops with this in mind. One of its possible **benefits is the ability for banks, insurers and asset managers to help individuals build personal financial resilience to overcome future crises.**

For many medium and small companies across the EU without ready access to public capital markets, the business interruption due to COVID-19 has resulted in firms taking vital bridging loans from banks to cope with the near-term liquidity pressure. Many of these loans are guaranteed by Member States and/or come with low initial interest rates. Bank debt financing has therefore increased (particularly for SMEs) and the accumulation of further debt onto corporate balance sheets may, in some cases, create an unsustainable burden. This will undoubtedly weigh on the future economic recovery.

Public capital markets have a major role to play in providing solutions to growing private sector leverage, whether that is through using securitisation technology to remove loans from banks' balance sheets (freeing that latter up for new lending) and offering borrowers alternative refinancing solutions, or by creating innovative mechanisms to convert bank debt into equity or equity-like instruments where growth capital is necessary. **Institutional and international investors, using public capital markets, can play a major role to facilitate this vital recapitalisation and re-equitisation work in the coming years as governments unwind their support**.

The IRSG recognises that the CMU is a long-term project rather than an emergency measure, and is not an answer to immediate issues nor issues that will arise in the next year**. A fully functioning CMU is a means to be better equipped for the future.**

CAPITAL MARKETS RECOVERY PACKAGE, OR MIFID 'QUICK FIX'

As aforementioned, the IRSG recognises that the CMU is a long-term project rather than an emergency measure. In this regard, we understand the distinction between this narrow crisis response, and the fuller future MiFID review which will be central to development of CMU going forward. The **IRSG stressed the importance of a dialogue between UK and EU during forthcoming major changes to MiFID to reduce unnecessary market fragmentation.**

On **the Capital Markets Recovery package, the IRSG welcomes useful measures, for example, on costs and charges exemptions for per se professional clients and eligible counterparties, and a simplification of the product governance regime for less complex products..** In addition, we support the removal of the Best Execution public reporting requirement (RTS 27 and 28).

We will continue to engage with this important package as it progresses.

CREATING A VIBRANT AND COMPETITIVE BUSINESS ENVIRONMENT

Insurance

The IRSG is pleased to see the recognition in the HLF report of **the role that insurers have to play in the development of the CMU.** Insurers have a critical role in the CMU as institutional investors. This is evidenced by the link to the Pensions recommendations and the role insurers can play in maximising the impact of the use of those funds in the CMU. Taking the broader view of the role of insurers in the way the Forum has complements the role that insurers will also be able to play in delivering the Green Deal and in the economic recovery to the pandemic, where significant private finance will be required.

We support the technical areas of Solvency II identified for reform to give effect to the policy aims. While the report rightly notes the particular emphasis on equity investing, insurers also invest in debt and this should not be forgotten in implementing the report. Our view is **that the recommendations reflect a well-constructed package of reform designed to achieve a broad outcome**. In that light it will be important that the recommendations here are approached as a whole. There will be a real risk that if the recommendations are only selectively implemented an opportunity will be missed to best engage a sector with trillions to invest.

It is also encouraging to see that in taking the wider view the Forum recognised that the policy aims cannot be achieved by regulatory changes alone. T**here are significant gains to be made if the envisaged policy mechanisms to bring businesses of all sizes and insurer investors together can be calibrated in the most effective way.**

Support for market making

It is important that **prudential regulation remains proportionate and fit for purpose as regards the important role of banks and others to support secondary market liquidity** when acting in their capacity as market makers. The IRSG encourages the Commission to take this into account in the context of the upcoming Basel 3 final legislation in the EU (Capital Requirements Regulation 3). **The key areas of focus would be trading book capital requirements (FRTB) funding (NSFR) and SA-CCR treatment of end-users.**

Securitisation

The IRSG **welcomes the recommendations on securitisation** and the comments by David Wright, HLF CMU Sub-Chair, that identify securitisation and the creation of a European EDGAR as two things to fix quickly.

European Single Access Point (ESAP)

Without commenting on the technical feasibility, **in principle we support the creation of a European EDGAR** as something that is visible which may also help to change the culture.

BUILDING A STRONGER AND MORE EFFICIENT MARKET INFRASTRUCTURE

CSDR (specifically issues with mandatory buy-in regime)

The IRSG **supports the objective of improving settlement efficiency in European capital markets** and believes that two aspects of CSDR's Settlement Discipline regime, namely cash penalties and rules on confirmation processes, will contribute to achieving that goal.

Nevertheless, we think it is **regrettable that the High-Level Forum has not recommended a review of the CSDR settlement discipline regime in order to remove the mandatory obligation on investors to execute buy-ins.** The mandatory buy-in regime, as currently constituted, risks having significant negative implications from a trading and liquidity perspective. This obligation will lead to higher issuance costs and reduced access of issuers to primary markets, and to increased costs, reduced liquidity and reduced investment returns for investors.

The COVID-19 crisis shows the potential for significant variations in the relevant data points, and that periods of high volatility and low liquidity will further increase costs for both issuers and investors. **The impacts observed during COVID-19 would have been further exacerbated by the existence of a mandatory buy-in regime.**

In particular, firms sitting in the middle of a settlement chain that spans the EU and a third country face risks created by discrepancies between the EU regime and those operated by third countries. T**he IRSG would welcome the provision of cross border settlement services in the EU.**

We note the recent speculation that there may be further postponement to the implementation of CSDR. If this is the case, we would urge the Commission to consider the issues outlined above during this extended period.

Consolidated tape

The IRSG **believes there are potential benefits of a European consolidated tape.** Under MiFID II, a consolidated tape was proposed to address fragmentation, itself a by-product of increased competition amongst trading venues. This would clearly **benefit Europe's end-investors by providing retail and institutional investors alike with a single authoritative price at which stocks trade in Europe.**

It would also potentially benefit European issuers **by lowering the cost of capital and represent a meaningful step towards completing the Single Market in financial services**.

FOSTERING RETAIL INVESTMENTS IN CAPITAL MARKETS

The IRSG welcomes the fact that the High-Level Forum did not solely look at capital raising and market infrastructure, but also the source of the capital. Therefore, the IRSG welcomes the focus on **participation by European citizens in capital markets.** The UK has experience to share on many of the report's proposals, in particular on inducements, pension auto-enrolment and the qualification of advisers.

The IRSG provides some overview of these below, but we are also happy to provide further detail the future.

Pension auto-enrolment

The IRSG **welcomes the recognition of the value of pursuing policies like auto-enrolment from the perspective of addressing the issues arising from the ageing population**.

In principle, auto-enrolment is a very useful way of encouraging additional provision to supplement Member States' Pillar I provision where the government is not inclined to impose mandatory additional provision. It makes use of inertia by requiring people to act to 'opt out' of contributing to a pension.

The UK has experience of both the success, but also the challenges, arising from auto-enrolment. **One particular challenge is ensuring the adequacy of contributions required to match expected retirement income.** This is an increasing issue in the UK and there are real policy challenges to be met. **The EU is well placed to address those issues from the outset** in making policy proposals in this area and it is important that it does so.

As it develops its proposals **the EU might also want to consider how pensions policy can "nudge" behaviours that benefit retail investors and increase the adequacy of pension contributions**. Pensions and employment offer a unique opportunity to provide people with guidance at important life events that trigger positive investment decision making at opportune times. Good examples of this, that are not tied to particular products or services, are the **mid-life financial checks offered by some employers and pension providers in the UK.**

Open Finance

IRSG recognises that this is a new area to both the EU and UK and we would welcome **cooperation between the two jurisdictions to share best practice and work together as the concept develops**. The IRSG therefore agrees with the Commission **that open finance has the potential to facilitate better financial planning and encourage investment.** Its development could go some way to address key challenges in areas such as personal financial management dashboards, automated switching and renewals, new advice and financial support services, and creditworthiness assessments.

Open Finance has the potential to bring a range of benefits to EU citizens. While open banking was introduced in the UK as a measure to improve competition in the market, rather than as a solution to a specific customer problem, the concept of open finance has a more customer-centric focus.

The IRSG also underlines the need to **consider wider social conditions to ensure open finance is a success.** It is clear that there are several cases where open finance could solve specific industry challenges. However, that **does not mean it would deliver the same outcomes in all sectors, Some areas will require specific protections to minimise the risk of consumer harm, for example in long-term investments and pensions markets, where excessive switching or switching without advice could result in adverse consumer outcomes and higher costs to consumers**. There is also the need to encourage take-up and engage citizens, who are frequently told by regulators and governments to protect their data, to share this data in order to see benefits. The IRSG also stress the need to work towards a level playing field to ensure that horizontal data sharing is taken into account, and information is shared in both directions.

PRIIPs

The IRSG believes resolving issues relating PRIIPs is a particularly pressing issue, especially in light of the impending expiring of the UCITS exemption. We also welcome the longer-term intention to review communication with investors, and facilitate such communication in a way that suits them, including through the use of technology. One change we would support in particular would be further guidance or amendments to both PRIIPs and MiFID Product Governance to ensure that retail investors have the ability to invest in corporate bonds, which would also give corporate issuers access to the considerable pool of retail savings.

NEED FOR STRONG POLITICAL COMMITMENT

The IRSG agrees with the authors of the High-Level Forum Report on the Capital Markets Union that swift and decisive political commitment is the best way to ensure this project succeeds.

The re-vitalised CMU initiative must have a **clear timetable, practical measures, coordinated supervision, and effective enforcement mechanisms - and must have full political support at the highest level.** Absent this, focus and attention will be lost to the ultimate detriment of the European investor and saver, the ultimate end-user of European capital markets.

CONCLUDING COMMENTS

The IRSG continues its longstanding support for the CMU project and welcomes the High-Level Forum Report on the Capital Markets Union, particularly as regards the CMU's external dimension and in the other areas outlined above. We stand ready and willing to continue to engage with the European Commission on this important project and look forward to opportunities to exchange more detail in the future.

We thank you for considering this submission.

Contact address:
IRSGSecretariat@cityoflondon.gov.uk

ANNEX - IRSG EU REGULATION STANDING COMMITTEE – MEMBERSHIP

ABI
AFME
Allen & Overy
Aviva
Barclays
BlackRock
Bloomberg
BNP Paribas
BNY Mellon
Citadel
Citigroup
City of London Corporation
CME Group
Credit Suisse
DLA Piper
Goldman Sachs
HSBC
Invesco
JP Morgan
Linklaters
Lloyds Banking Group
London Stock Exchange Group
MarketAxess
Morgan Stanley
Nasdaq
PIMFA
Prudential
PwC
Refinitiv
Schroders
Société Générale
Standard Chartered
State Street
TheCityUK
UBS
UK Finance
Willis Towers Watson