III. FUTURE STEPS OF THE CMU

Issues at stake

The EU capital market legislative framework has been significantly enriched with the two Capital Markets Union action plans put forward by the Commission (2015 and 2017), which have now mostly been implemented. However, the general feeling is that much remains to be done to achieve the CMU.

The Commission reaffirmed at the end of 2019 its commitment to the CMU and the Council set policy objectives for deepening the CMU related to the funding of SMEs, retail savers, the removal of structural and legal barriers to capital flows, the support to the transition to sustainable economies and technological progress and digitalisation.

A High Level Forum (HLF) set up in November 2019 by the Commission aims to propose by the summer of 2020 a set of concrete and targeted policy actions, likely to be "game-changers" for the CMU, together with the method and process needed to see them through. An interim report published in February 2019 outlined the key areas of work of the HLF going forward including measures for the financing of businesses, the strengthening of market infrastructure, retail investment, tax and insolvency procedures and supervision. The HLF also emphasized the need to have a clear delivery timetable that can be rigorously monitored and the importance of an upfront commitment from the EU institutions on a precise package of reforms.

Content

CMU 2.0: what is needed, by whom and when?

Jörg Kukies

State Secretary Financial Market Policy and European Policy, German Federal Ministry of Finance

A step-by-step approach will ensure best progress on deepening the Capital Markets Union

The corona pandemic and the impact of containment measures impede the access to capital markets for small and medium sized enterprises as well as for large corporates. This counteracts the significant steps towards the development of the Capital Markets Union, which the EU has taken over the last years. More than ever, we need to work on ensuring future-proof financial markets in the Union. Further steps are required to promote capital market-based financing, to integrate and strengthen the European capital market further and to make it internationally competitive.

Together with France and the Netherlands Germany has therefore taken the initiative and set up a working group of acknowledged European experts in the area of capital markets from various Member States to provide recommendations to deepen the Capital Markets Union (NextCMU).

In its final report, the NextCMU group has outlined some of the key issues we need to address. First, in order to further develop financial markets, in particular equity markets, the listing burden for SMEs should be reduced in a proportionate manner (this could be achieved, for instance, by review- ing the MAR), investments in Venture Capital should be promoted (e.g. through creating EU-wide funds-of-funds schemes) and retail investment in financial markets should be increased (e.g. through introducing a new category of semi-professional investor). Second, in the interest of long-term savers and investors, it needs to be ensured that a wide range of long-term financial products is offered – also in a low yield environment.

This objective should be appropriately reflected in the regulatory framework (Solvency II). In addition, savers should be further incentivized to turn into investors (e.g. through encouraging workplace equity investments and improving financial education), while at the same time ensuring adequate investor protection. Third, to ensure the free flow of capital between EU financial market places, remaining barriers in the internal market need to be removed (in particular in the area of post-trade), further consolidation of intermediaries and infrastructures should not be hampered and an EU wide Digital Finance Action Plan should be adopted. Last but not least, the EU financial markets will only flourish when they are liquid and competitive. To further develop EU financial markets, sovereign green bonds should be established, securitization markets need to be revitalized and a pan-European payment market should be created.

> *It is now up to the European Commission to translate the NextCMU recommendations and the ECOFIN priorities into specific proposals for legislative amendments.*

Building on the work of the NextCMU group Finance Ministers agreed at the ECOFIN meeting under the Finnish Presidency in December 2019 on key priorities for the Capital Markets Union. These include better access for small and medium-sized companies to Europe-wide, cost-effective, capital market-based sources of finance, improved Europe-wide range of diversified, long-term and sustainable pensions, savings and investment opportunities, increasing retail investor participation in financial markets, removing remaining barriers to cross-border financial flows and a digital financial market union. These priorities may not be implemented overnight, but require a step-by-step approach.

It is now up to the European Commission to translate the NextCMU recommendations and the ECOFIN priorities into specific proposals for legislative amendments. The European Commission has established a High Level Forum of ▶

European experts to provide further input into their work and to inform their Action Plan. An important first step to bring forward the CMU would be the short-term revision of the core regulatory framework for financial markets in the EU (MiFID II and MiFIR). A market consultation conducted by the German Federal Ministry of Finance last spring has shown a clear need for targeted improvements, which since then has been reinforced by the Brexit. The European Commission should therefore intensify its work on the MiFID II/MiFIR review and prepare a legislative proposal with high priority.

The incoming German Presidency is looking forward to appropriate legislative proposals from the European Commission to overcome the negative effects of the corona pandemic and the containment measures on the access to capital markets by deepening the Capital Markets Union.

Odile Renaud-Basso

Director General, French Treasury,
Ministry of Economy and Finance, France

A CMU rooted in the European economy

This article is written as the CoVID 19 health crisis is hitting European nations and their economies hard and in an unprecedented manner. No one can predict the consequences of the crisis but surely, immediately after the crisis, we will need to mobilize all the driving forces of our economies and, above all, we will undoubtedly need to act with redesigned economic tools. The day after the crisis will not be the same as the day before the crisis. The world will need even more cooperation between Europeans and a Europe capable of mobilizing its economy in a strong way to start rebuilding and reorganizing its economy.

The central contribution of CMU to the macro-economic stabilization of the European Economy is to provide a private risk-sharing mechanism. The CMU reflects Europe's design for its capital markets, both domestically and in relation with other markets worldwide. As Europe has the most open markets in the world, it is crucial to ensure the competitiveness of its financial services providers. The CMU will bring a decisive contribution into shaping the European sovereignty. It is clear, that in the long-term growth innovation and the green transition will require significant additional capital in the European economy. A significant part of this investment gap needs to be filled by equity rather than debt, in order to provide an adequate financing to these projects. As emphasized by the ECB, long term sources of financing are required as these investments have a long term or even very long-term horizon.

In a context of increased capital requirements for banks and taking into account the structural differences with their peers, relying on the sole channel of bank financing would limit our collective ability to raise the deeply-needed capital and would make us lag behind our peers. US banks benefits to a greater extend from the possibility to securitize and deconsolidate the mortgages on their balance sheet. Even if bank financing is the preferred financing mechanism in Europe, improving the functioning of our capital markets thus appears to be a necessity. In order to tackle this existential challenge for the European economy, it is paramount that the European Commission delivers on a realistic and proactive action plan as early as possible in 2020.

Based on the Ecofin Council conclusions from the 5th of December 2019 and on the numerous recent reports on this topic, in particular the Next CMU report, the High-Level Forum (HLF) still has to put forward concrete realistic proposals. If allegedly the previous 2015 action plan from Commission was somewhat watered down at the legislative phase, no one would understand that the Commission does not seize the opportunity to build upon the Council's ambitious conclusions.

As for concrete priorities, first the CMU must adapt to the green and digital transition, both in its means and objectives. Non-financial reporting and taxonomy require to build upon robust common standards to avoid market fragmentation which would arise from diverging labels and definitions. New technologies offer opportunity to revisit existing financial functions but need at some point a regulation based on the "same activity, same risk, same rules" principle.

Second, the CMU requires strong, efficient and demanding participants. On the one hand, we need capital on the

European Capital markets. This means that there will not be any CMU without the active implication of resilient CIB, nor without the investment of insurers into equity. Thus, a careful transposition of Basel III and an adjustment of Solvency II are uppermost needed. On the other hand, companies and especially SMEs deserve to access this financing more easily. The increase of financial transparency and any measure to facilitate IPOs would be welcome here. Last, -and this, surely, will be critical in the post CoVID 19 context- we must improve the level of trust among market participants, so that the benefits of the retail flow to the markets remain. There is still room to enhance the training of financial advisors, deliver more concise and adequate information to the costumers and take advantage of new technologies to improve European customers' experience.

Harald Waiglein

Director General for Economic Policy, Financial Markets and Customs, Federal Ministry of Finance, Austria

Priorities and factors of success for the next CMU-initiative

Deeper integration of EU-Capital Markets should enable easening the access to capital and liquidity for EU companies as well as to diversified investment opportunities for investors in line with their risk appetite and needs. The Capital Market Union-Initiative 2015 - 2019 has shown that a comprehensive approach enables progress in capital market integration. However, further steps are needed to accomplish the ambitious goals of the initiative.

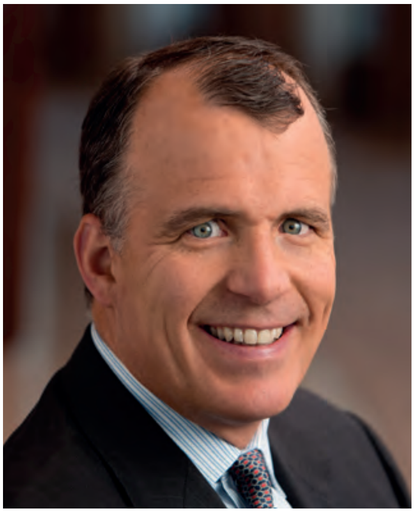
The Capital Market Union 2015 - 2019 was characterized by an evolutionary approach. Room for improvement was identified and legislative and non-legislative measures expedited by the Commission and adopted by Member States and the European Parliament. I anticipate that the Next Capital Market Union will again follow this approach thus moving forward towards a truly integrated, liquid and competitive capital market.

In my view, a holistic approach is needed thus addressing also obstacles outside the financial and capital market regulation, e.g. in the insolvency law to advance in the spirit of the CMU. Furthermore, it will be of importance to have a close look to some of the applicable legislation as well as on international standards to be implemented in due time. With regard to existing legislation we should change elements associated with excessive bureaucracy thus limiting the investment opportunities for customers and the competitiveness of EU-markets and enable up-to-date-solutions for existing and arising deficiencies. When transposing international standards, e.g. Basel IV, we should keep the supervisory standards achieved after the financial crisis but prevent competitive disadvantages by using a pragmatic approach which sufficiently respects EU-specifities and business models.

It is not the time to restrict priorities for the Capital Market Union. Additional game changers have arisen. Covid-19, BREXIT and climate change policies will have to compliment effective digitalization-policies within the Next Capital Market Union. We will have to mitigate the negative impacts of Covid-19 and BREXIT on Capital and Financial Markets and on the real economy in a decisive manner while not disregarding effective measures to address climate change and the transformation to a more digitalized EU. The next CMU has to incorporate reactions to game changers to achieve progress.

The reactions to the spread of Covid-19 throughout the EU has shown the positive effects of an advanced digitalized environment as well as remaining deficiencies to be overcome. We could all monitor to what extend Covid-19 hit financial and capital markets as well as the coordinated responses of EU-institutions. We are also looking forward to an European Union without the United Kingdom and the challenges to be overcome when the most liquid and progressive market stays outside the EU. Also in this regard we should aim for a pragmatic solution. Climate change remains one of our main and urgent challenges. We have to act to contain social and economic costs for future generations.

I am convinced, that the EU is capable of finding good and effective solutions to these challenges. In my view, it will be of key importance to demonstrate openess by acting and not only reacting to these challenges. In particular, the continent should learn from more advanced financial and capital markets and incorporate an open and progressive approach to ensure the competitiveness and efficiency of EU-markets also in the medium and long-term perspective.



Bruce R. Thompson

Vice Chairman and President, EU and Switzerland,
Bank of America

The time is now for a CMU for the businesses and citizens of Europe

Ever since its September 2015 communication, the European Commission has made it a top priority to develop a Capital Markets Union (CMU) in the EU. At the time, President Jean-Claude Juncker faced a Union struggling with high unemployment and in need of investments that could generate jobs. With a banking sector still under the constraints of both the financial and Eurozone crises, traditional funding sources had to be complemented to channel capital to all companies, including those that form the backbone of the European economy, SMEs.

While an ambitious Action Plan was immediately put in place, new challenges such as the departure of the largest finance centre from the Union, technological developments and the need to seriously tackle climate change make the project even more crucial for the future.

> *These challenging times should be seen as an opportunity to do things differently.*

This is why President Ursula von der Leyen made completing the CMU one of the cornerstones of her Presidency. One of the European Commission's first actions in this renewed impetus has been to create a High-Level Forum (HLF) composed of experienced industry executives and international experts and academics, with the aim of providing suggestions and guidance on future CMU policies; the sudden change in the economic outlook as a result of the COVID-19 crisis make this work even more of a priority – Europe needs its capital markets to be as large and liquid as possible to maximise funding sources to support citizens and businesses.

As a member of the HLF subgroup focusing on the development of European capital markets architecture, I am struck by the clear conviction among all HLF members that the future of the Union requires the development of a truly integrated CMU.

While many reports have been published on the matter, the HLF intends to set aside broad policy recommendations and focus instead on concrete policy measures as well as the method and processes needed to see them through. The HLF's recommendations, expected in May, will not target "low-hanging fruit", but instead aim for measures that will lead to tangible results, no matter how hard they are to achieve. These challenging times should be seen as an opportunity to do things differently.

While work is still underway, the final report will likely focus on a dozen or so recommendations centred around four broad categories:

- Financing for business: the HLF will consider issues such as enhancing the transparency and comparability of company data for investors, supporting the development of cross-border long-term investment vehicles, increasing the risk appetite of institutional investors, facilitating the listing of companies, and strengthening the tools available to financial intermediaries – such as securitisation.
- Market infrastructure: we are looking at enhancing the integration and efficiency of trading and post-trading, as well as improving the liquidity of secondary markets by strengthening the role of European intermediaries.
- Retail investment: conscious of current demographic and environmental challenges, the HLF will propose measures to steer citizens towards sustainable, long-term investment products through the development of adequate occupational and personal pension products. This will also require putting in place a strong financial literacy and equity culture in Europe.
- Cross-cutting issues: these are the pressing issues that are considered politically sensitive but must be tackled – issues around withholding tax for cross-border investors, the harmonisation of national insolvency proceedings, and the need for a true level-playing field for financial players across the Union.

While Rome wasn't built in a day, it is time for policy-makers across the Union to deliver on their political promises and boldly push for reforms that will make the EU a true global capital markets player. European citizens stand to gain significantly from an integrated and open CMU – a well-developed pool of capital that will not only enable wider household and retail access to capital markets but also finance the SMEs that drive the European economy forward.

Leonique van Houwelingen

Chief Executive Officer, BNY Mellon SA/NV

Capital markets policy – Incisive steps to make progress

I started writing this article about a week ago. In that week the world has become a different place. Some things seem much more important; other things much less important. Capital markets policy doesn't seem very important for the moment. But I do sincerely hope that when this article is published capital markets policy will have regained some importance. Lessons and challenges.

As we recover from the devastating personal, social, and economic impacts of the COVID-19 virus, it will be possible to reflect on some important lessons, and on some major challenges. Two key challenges will be how to make our societies and economies better prepared and more resilient for the next crisis, and how to recover from the current crisis.

Capital markets policy. In this context, capital markets policy has a role to play. One of the main justifications for the Capital Markets Union project has been that a greater role for capital markets, and for cross-border capital markets, improves the ability of an economy to absorb external shocks. The current crisis has caused major economic disruption, and financing problems for many corporates, including banks and SMEs. Improving the financing mechanisms of capital markets can help support the future financing of corporates.

Key principles. A week ago, I would have said that key principles for a bigger and more effective European Capital Markets Union are simplicity, developing market access, and encouraging diversity. Today, I would add the principles of resilience, decentralisation, and inter-connectivity. I see all these principles as having common elements, including the importance of common definitions, and a key dependence on the widespread use of standards.

Practical proposals Capital markets policy has few tools that can have a rapid impact. Other policy areas, such as monetary and prudential policy, and supervisory actions, have a much speedier impact. Capital markets policy deals with the structures and institutions that allow issuers and investors to use capital markets. But the slowness of their impact is precisely why we need rapid, clear and incisive capital market policy measures.

We need three things. We need measures to bring investors to the market; we need measures to bring issuers to the market; and we need measures that reduce cost, complexity and risk in the use of infrastructure and intermediaries, especially with relation to cross-border investment. Measures to bring investors to the markets should include the development of pension funds, and the use of investment savings accounts to encourage direct participation in capital markets by retail investors. Measures to bring issuers to the markets should in particular tackle barriers for securitisation and for SMEs. Measures to reduce cost, complexity and risk in cross-border investment are typically the most challenging, as they affect policy areas (for example, tax and insolvency procedures) that are deeply embedded in national law, and their benefits may be difficult to see. But they deal with the foundational building blocks of capital markets, and they are critical pre-conditions for progress. They include common definitions, for example, of a financial instrument, and of a shareholder/legal owner of a security.

Today, I would add the principles of resilience, decentralisation, and inter-connectivity.

A Capital Markets Union will mean that investors in any European security are faced with common operational processes through the full life cycle of a securities investment, including common corporate action, and common withholding tax processes. This will require measures to facilitate cross-border and pan-European issuance, measures to ensure the harmonisation of core CSD processes, and a high degree of integration of tax processes. All these measures are desirable in themselves, but they have the additional benefit that they help build resilience in capital markets through decentralisation and inter-connectivity between capital market eco-systems. Report of the CMU High Level Forum. Despite the current difficult times, I am optimistic for the future.

I am confident that the final report of the European Commission's High Level Forum on the Capital Markets Union will contain some important transformational recommendations. And I am confident that the European Commission will take serious account of the recommendations in its future CMU Action Plan.

Deborah Zurkow

Global Head of Investments, Allianz Global Investors

What do we see as priorities for the CMU to have a good chance to solve the pension dilemma?

Written as of March 16th, 2020 - The Capital Markets Union (CMU) has the ambitious mission to align and integrate Europe's financial system. This is a challenging but critical task, as the success of the CMU may well determine not only the strength of the EU's economy and its financial sector, but also the ability of its institutions and companies to serve its citizens now, and in the future.

If the main CMU's goals are fulfilled, two imperative needs of citizens will be solved: maximise their current quality of life and their current income by mobilizing capital to invest in Europe's companies, while simultaneously putting savings to work to guarantee retirement income adequacy.

Our starting point is the EU's very fragmented capital market from a regulatory point of view. National tax, corporate, securities and insolvency laws, come on top of very different procedures and practices from country to country. In addition, Member States are on very different stages of their respective business cycles, which makes it hard to make that one solution fits all.

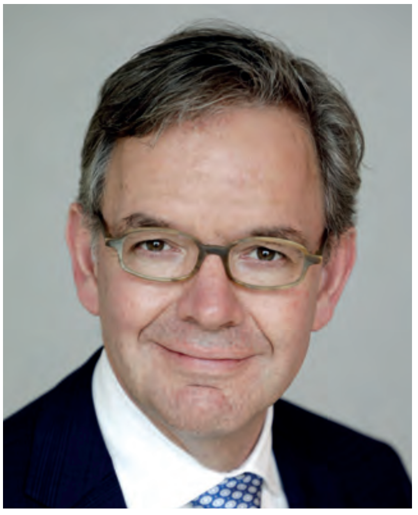
This diversity quickly becomes complexity and it deters market access and portability. Greater harmonisation across Member States will facilitate broader and more diversified investment opportunities for pensions funds and the ultimate savers they represent. In the absence of further alignment between Member States markets will be unable to play their role in maximising retirement income adequacy.

Cross border alignment and collaboration, as well as openness to change in favour of innovation, simplification and harmonisation will be key to solve the structural pension threat. Priorities in my view are 1) channelling long-term savings into financing entrepreneurship, 2) rethinking individual Member State approaches in favour of greater Pan European coherence, and 3) ensuring global competition of the EU in capital markets.

- **Channelling long-term savings into financing entrepreneurship;** A regulatory environment favourable to long-term investment would certainly help to enhance the offering of available savings products such as employees' savings schemes. Member States should work together and share best practices to undertake aligned measures that expand the amount of pension savings being invested. For this, unnecessary obstacles would have to be removed, and tax incentives would provide a much-needed support. One way to do this would be to recommit to a Pan European Pension Plan that allows citizens in all member states to direct their retirement savings into the capital markets in an aggregated and risk controlled way, with common regulatory and taxation principles that allow these savings to be transportable between countries in an efficient manner.
- **Rethinking individual Member State approaches in favour of greater Pan European coherence;** Member States should be encouraged to simplify and standardise withholding tax procedures and mutual fund taxation to encourage increased retail participation as well as greater cross-border asset ownership for institutional investors.
- **Ensuring global competition of the EU in capital markets;** Deeper and more competitive financial markets will contribute to growth through efficient allocation of capital. We need policy measures that balance market resiliency, market integrity and appropriate supervision with keeping Europe's capital markets sufficiently open and competitive in order to grow their capacity. This will promote further investment, continue to reduce reliance on banks and will create employment. There is also significant room to improve integration of financial centres, and to attract investors and companies from around the world.

> *The Capital Markets Union has the ambitious mission to align and integrate Europe's financial system. This is a challenging but critical task.*

In a nutshell, the investment challenge is well beyond the capacity of the public sector alone. Within the ambitious mission of the CMU, asset managers not only will help savers maximise their returns and mitigate investment risks, but also will be able to act as active stewards of capital, supporting sustainability through important extra-financial considerations such as ESG and climate, contributing to long-term health and sustainability of capital markets and society as a whole.



Steven Maijoor

Chair, European Securities and Markets Authority (ESMA)

The priority areas for the CMU

The imbalance that exists in the European Union between bank and capital markets funding makes the EU less competitive and less financially stable than it could be. Creating globally competitive markets takes time and we have yet to fully achieve that, but the UK's withdrawal from the EU reinforces the urgency of this goal: in the aftermath of Brexit, the EU will only be able to compete effectively with other major financial centres and reinforce its economic growth if its financial markets are sufficiently sizable – and further integrated. Moreover, in the context of the COVID-19 pandemic and its economic fall-out, stronger EU capital markets may play an important role in the recovery phase.

While the CMU is, in its current form, a relatively new project, achieving common capital markets is, more generally, a long-standing EU goal. Much progress has already been made, with successful market integration being observed in areas such as funds, trading venues, and clearing.

Looking forward, efforts should be focused on three priority areas which are essential to achieve a successful CMU: (i) Develop retail investor participation in EU capital markets; (ii) Improve capital market access for EU SMEs; (iii) Ensure effective consistent supervision in EU financial markets.

Looking at successful capital markets across the globe, a high level of retail participation should be an essential characteristic of a CMU. Some of the key reasons for scarce retail investor participation is their lack of trust in capital markets as a result of mis-selling cases, as well as limited financial literacy.

In addition, ESMA found in its 2019 and 2020 Reports on the performance and cost of retail investment products in the EU that costs associated with obtaining financial products are substantial and represent a significant reduction to long-term gains. Finally, due to a variety of disclosure rules applying, including on costs, it is not always clear to investors how different products compare with each other.

To address scarce retail participation in capital markets, several potential actions could be considered. Examples include: (a) further aligning disclosure requirements for investment products across different pieces of regulation and facilitating their cross-border distribution, (b) improving the distribution of financial products by looking into the incentives, like inducements, for advisors, and (c) reinforcing the role of pensions systems to stimulate retail participation in financial markets.

It is well known that EU SMEs tend to rely mainly on bank funding and that – when they access capital markets – they tend to privilege local markets due to easier access and lower information asymmetries for investors. For example, while venture capital funds can support the path towards IPOs, their presence is uneven across member states.

At the same time, it is fair to say that SMEs may pose increased risks for investors and it is challenging to develop rules that are appropriate for all types of SMEs at different stages of their development. The right balance should be found between making standardized information on SMEs available to investors across the EU, while the costs of such information to SMEs should be proportionate.

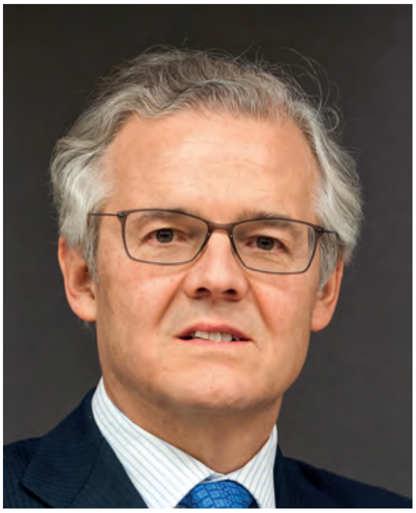
> *In the context of the COVID-19 pandemic and its economic fall-out, stronger EU capital markets may play an important role in the recovery phase.*

Other actions already taken in this area include the creation of SME Growth Markets under MiFID II. In this context, ESMA will soon launch a public consultation on an assessment of the functioning of the regime for SME Growth Markets. This consultation will include some suggestions to further promote the development of such markets in the EU.

Finally, regarding the role of supervision, it is well known that differences in supervisory practices increase the costs of doing business across the EU, and constitute a substantial barrier to cross-border investments. Over the past two years, the EU institutions have taken gradual steps towards expanding direct supervision at EU level. As a result, an increasing number of supervised entities will fall under ESMA's remit in the ▶

years to come. This concerns both EU and third-country market participants.

While the ESAs' review has introduced some useful changes to the supervisory convergence tools available to ESMA, these are less ambitious than those originally proposed. As such, there are further opportunities to enhance ESMA's supervisory convergence role further via a refined toolkit, especially regarding its ability to ensure the implementation of common supervisory practices.



Sebastián Albella Amigo

Chairman, Spanish Securities and Exchange Commission (CNMV)

Rethinking CMU: the importance of local markets

Although many of the specific objectives initially envisaged in the context of the CMU project have been reached, we are still far from achieving a truly integrated an efficient capital market in Europe. Additionally, there is a need to rethink and relaunch the whole project considering challenges arising from Brexit.

Therefore, it is time to propose additional actions. From my point of view, the key priorities for the next phase of the CMU should be three: increase the equity market share in funding, tax harmonisation and supervisory convergence.

Firstly, the need to foster market-based finance for companies is especially acute on the equity side. Being listed broadens the possibilities of financing, boosts the level of professionalism and rigour in management, is an incentive to grow, gives prestige, strengthens the brand, helps to attract and retain talent, etc. and, since it is compatible with maintaining control, is a very natural solution for successful family businesses of a certain size.

More listed companies also mean more transparent companies and even a somewhat more democratic society: it means that there are more companies within reach, either directly or through funds, for any investor. For these reasons, any restrictions on the capacity of firms to access capital markets should be removed and no extra restrictions or conditions should be imposed on companies associated with the fact of being listed.

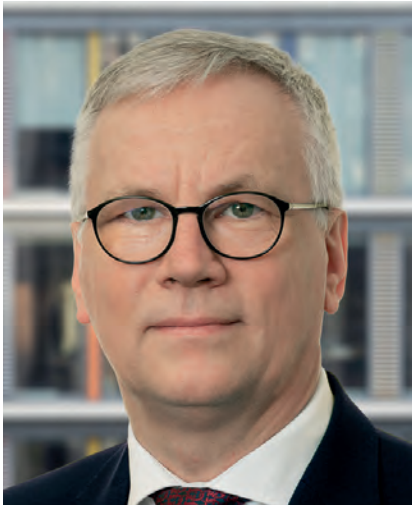
Secondly, there is also a need to make progress on tax harmonisation. Current different tax regulations distort financial decisions, reduce efficiency in capital markets and influence too much cross-border capital flows. There is room to reduce the vast differences across Europe in the tax treatment of financial markets' transactions and SME investments. Heterogeneity in this area creates too diverging distribution models for financial instruments (insurance, banking and securities products).

Finally, the CMU project needs to emphasise the convergence of supervisory practices. In order to homogeneously apply the European rulebook it is of paramount importance that ESMA intensifies its efforts in supervisory convergence by using in all appropriate cases the tools and powers granted by law. Regarding the home/host supervisory model in the EU, it would be an improvement if the host NCAs were provided with the appropriate information on the activities carried out in their jurisdictions. The establishment of formulas for cooperation between home and host authorities is essential in order to avoid a "race to the bottom".

Additional actions to relaunch CMU must coexist with strong local financial markets.

This is especially relevant in a context in which there is certainly a need to create an integrated, competitive, deep and liquid capital market, but this should not imply the creation of a single or dominant financial centre or the weakening of the main European local markets, i.e. any additional actions to relaunch CMU must coexist with strong local financial markets.

They benefit medium-sized companies that are large enough to tap local capital markets, without preventing them from looking for capital across borders. Geographical proximity lowers transaction costs, helps to overcome cultural barriers of entrepreneurs and helps investors to understand the businesses that they are financially supporting.



Rimantas Šadžius

Member of the Court, European Court of Auditors

EU auditors call to address essential limitations of ESAs

The EU was plunged into a pool of uncertainty this year with regards to the financial sector as it continues to try and find tools to offset the massive economic fallout of the coronavirus crisis – which could likely require a global effort. The negative impact of the pandemic on the financial markets is evident, pushing to obscure transformations and making future structural changes inevitable (as of now). However, a need for sound supervision will surely stay instrumental, and thus, past lessons in building a harmonized approach to the EU-wide financial sector still need to be learned.

Common rules for the entire EU financial sector, or the single rulebook, are meant to ensure a more effective level playing field and prevent negative cross-border spillovers stemming from possible regulatory arbitrage. However, despite a large number of regulations and directives put in place since 2009, the bulk of direct supervisory controls and enforcement responsibilities still rest with national competent authorities and supervisors. As a result, even with more intensive coordination and approximation of national laws to reinforce the internal market, the rule framework remains fragmented due to different transposition or interpretation of rules, different supervision approaches, and most importantly, very limited EU level enforcement instruments.

So far, all three ESAs acting within their mandates can be praised to have indeed effectively contributed to a smoother functioning Single Market for financial services. At the same time, we can observe that in terms of the types of possible response to various developments in the financial area, the EU is constrained in its competences defined within the Treaties, although notably, EU legislators enjoy ample degree of flexibility in these issues. At present, strong national interest and a legally permissible degree of arbitrage (in setting national regulations, supervisory practices or enforcement approaches) related to the financial sector limit the possibility to take fully effective and proactive measures at EU level, because a difficult consensual approach in many cases has to be applied. Therefore, to overcome persisting strong national borders and to make the single rulebook work, ESAs should evolve from being “de jure” authorities to “de facto”.

The mandate and role of ESAs as centralized bodies for capital markets and conduct-of-business supervision were discussed intensively recently. In its audits of EIOPA and EBA, the European Court of Auditors has identified a number of serious, systemic gaps in the supervision of the EU’s banking and insurance sectors. In our work, for example, we pointed out a too limited role of ESAs, especially EIOPA and EBA, in supervisory colleges (for cross-border groups). The complicated functioning model of supervisory colleges and even the lack of proper arrangements concerning information exchange could bring about vast inefficiencies.

To make the single rulebook work, ESAs should evolve from being “de jure” authorities to “de facto”.

We called upon EU legislators to adjust accordingly the respective regulations and frameworks. We recommended, among other measures, to rethink both the governance and powers of the ESAs. Of course, another question is what should come first: whether it would be optimal to grant ESAs more powers before fixing identified issues in their governance and resources.

Along with the banking and insurance sectors, we also feel there are similar issues in the area of securities markets, investment funds, etc. Thus, we are about to start an audit of performance of the EU framework for non-bank finance intermediation to be able to provide a more detailed picture of it to EU legislators. ●

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How can new technologies support the CMU?

Carlos San Basilio

Secretary General of the Treasury and International Financing, Spanish Treasury

EU leadership in Fintech. How can new technologies help develop the CMU?

Developed and integrated capital markets, especially in a monetary union, are crucial to ensure a good match between savings and investments and an increase in cross-country risk sharing, contributing to economic growth and financial stability.

In order to pursue these benefits, definite progress needs to be made in the project of the Capital Markets Union, launched 5 years ago.

New technologies can play an important role in developing the Capital Markets Union, helping overcome barriers to integration. Indeed, new financial technologies (Fintech) create an array of new possibilities for financial agents, instruments and transactions, by improving the efficiency of financial activities, making financial markets more inclusive and improving regulatory and supervisory capacities of the public sector.

The efficiency of different activities such as equity and debt issuance, asset management or corporate governance can be improved with Fintech, allowing for better access to capital markets, reducing barriers and transaction costs and therefore, enhancing financial markets' competitiveness. Some concrete examples of this are crowdfunding and alternative investment platforms, virtual vote tools for shareholders, supply chain finance and robotic financial advisory.

New technologies can also make financial markets more inclusive by enhancing retail investors' activity through low-cost digital platforms and more transparent and trustworthy products. Deepening the integration of financial markets at a retail level is key for a successful Economic and Monetary Union that takes into account the needs of its citizens. Retail investors are the main source of long-term financing of the economy. A broader participation of retail investors in the financial sector can help smooth asymmetric shocks that may affect individual countries.

Furthermore, new technologies can help improve public sector's regulatory and supervisory capabilities, through the so called Regtech and Suptech. However, new technologies may also present risks from a regulatory and supervisory point of view. Thus, policy initiatives should be directed to boost technology development while at the same time, ensuring that financial consumer protection and financial system stability are guaranteed.

The regulatory sandbox, which will be launched shortly in Spain, pursues both objectives simultaneously. The sandbox allows firms to test their innovations under appropriate supervision by the relevant authorities. This helps not only innovators and consumers, but also the supervisors and regulators themselves by having access to valuable information which could, eventually, lead to further improvements of financial regulation and supervisory practices. This initiative responds to the well-defined need to push innovation as a central element for sustainable and equitable economic development. Likewise, it guarantees that technological change protects users of financial services, maintains financial stability and market integrity, while at the same time preventing money laundering or financing of terrorist activities.

It is time to make significant progress in the deepening of the Economic and Monetary Union and turn the Capital Markets Union into a reality. For that purpose, we should make use of any means at our disposal. New technologies have undoubtedly a very relevant role to play. Spain is ready to contribute actively to this endeavor. ●

Mario Nava

Director Horizontal Policies, DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

A digital Capital Markets Union

Digitalisation, new technologies and innovative business models hold great potential to support the objectives of the Capital Markets Union (CMU) by increasing efficiency, transparency and cross-border provision of services. The COVID-19 crisis shows that digitalisation may also be a safety net against operational risks, thus improving market resilience. The European Commission (EC) is thus taking the necessary steps to ensure the right conditions are in place to take advantage of and manage any risks stemming from digitalisation.

That is why digital finance has become a resounding public policy topic, as also reflected in discussions of the CMU High Level Forum (HLF) set up by the EC to identify and propose new targeted actions to further develop the CMU. Whilst it is too early to discuss the outcomes, these recommendations, including ideas on how digitalisation supports the CMU objectives, will be published later this year and will feed into the Commission Action Plan on Capital Markets Union. In parallel, ▶

the EC is working towards a broader new Digital Finance Strategy promoting digital finance in the EU while adequately addressing possible risks. A digital finance public consultation was launched in April 2020.

Distributed ledger technologies/blockchain may improve efficiency in trading and post trading, reduce costs and make it easier to raise financing on public markets via Security Token Offerings and DLT bond issuances. In December 2019, the EC launched a public consultation on crypto-assets to assess if the existing EU legislation should be adapted for the issuance, trading, clearing and settlement of crypto-assets and how to ensure a level playing field between security tokens and other financial instruments. A legislative proposal covering all crypto-assets is expected in Q3 2020.

Recent EU policy initiatives recognise the importance of data-driven innovation and data flows such as GDPR's right to data portability and PSD2's Open Banking provisions. CMU objectives, in particular retail investor participation in capital markets, may also be further advanced through open finance. If broadened to include other types of financial data, open finance could benefit consumers by enabling the creation of new business models which would equip them with better tools to manage their finances and investments as well as foster competition between service providers. In February 2020 the EC adopted a Digital Strategy to enhance access and sharing of data within the EU. This horizontal framework will be complemented by a sectorial framework for the financial sector.

Financial institutions increasingly rely on third party providers of IT services, and in particular cloud services. While these solutions bring opportunities, they also expose the financial sector to operational risks and potentially systemic risks which need to be mitigated. The EC recently launched a consultation on digital operational resilience. A cross-sectoral act is expected in Q3 2020, harmonising rules across the EU to make the financial sector more secure and resilient.

> *The EC is working towards a broader new Digital Finance Strategy promoting digital finance in the EU.*

By improving access to finance for innovative companies, the CMU will deliver on its objective of supporting growth and innovation in Europe, and in turn further advance the digital transformation.

Björn Sibbern

President European Markets,
Nasdaq

Artificial Intelligence + market surveillance = market integrity

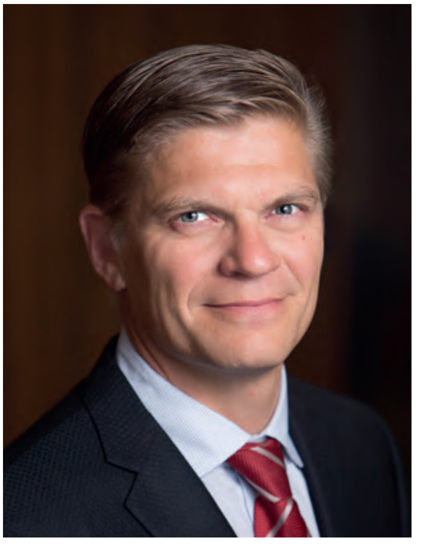
Artificial Intelligence is the defining technology of the 21st century that will upend industries, institutions and long-time incumbents. Modern artificial intelligence enables new, hyper-scalable capabilities which make otherwise bespoke or scarce solutions ubiquitous and accessible.

Machine intelligence is gaining deeper penetration at exchanges and clearing houses - we are using it to increase operational efficiency, create richer data products and provide better services to the market. Nasdaq reimagines capabilities such as alternative data research, trade surveillance, asset flow predictions, and investor relations and applies them to financial markets for institutional and retail investors.

Nasdaq was the first market to implement machine learning for market surveillance on the markets we operate in Europe and in the US, as well as providing such services to our technology clients. Nasdaq's European Surveillance team was the first surveillance team in the world that implemented machine learning into its surveillance technology and starting to use that in live production almost three years ago. When we are now also starting to use similar technology for our US market that will be helpful given that the Nasdaq's U.S. market surveillance team annually reviews 750,000+ alerts that flag unusual price movements, trading errors and potential manipulation.

> *...maintain the approach of not stifling but supporting innovation.*

The implementation for our European markets is benefiting from machine



learning to create a ranking score attached to new alerts from the surveillance system. In particular, it enable prioritization among incoming alerts in situations where work load is high, e.g. around opening of markets, it complements existing quality controls in relation to alert handling and it enables managers to identify outliers. This use of artificial intelligence enhances the market surveillance functionality and transfer learning to improve detection of malicious activity. Machine learning provides better opportunities for surveillance specialists to focus on the right cases, ensuring market integrity is upheld at its highest level.

Nasdaq sees benefits for this technology for exchanges and regulators worldwide, not least in the European markets where trading is fragmented. We also believe it will be useful in sectors which are outside the traditional financial markets, such as cryptoassets and also in the gaming industry. Among others, it can help monitor bets and for instance detect possible money laundering cases.

Nasdaq continues within its Innovation Lab to research and build unique products that combine our proprietary and third-party data with machine intelligence capabilities. This allows us to work hand in hand with market participants to jointly build products that support investors' ability to build and protect assets today, and in the future.

Given the huge opportunities ahead, already under exploration or still to be detected, Nasdaq would urge policymakers to maintain the approach of not stifling but supporting innovation. As traditional business models are challenged and where regulatory intervention is considered, we also fully support the principle of 'same business, same rule', which has so far been guiding the regulatory development.

Adrian Poole

Head of Financial Services, UKI, Google Cloud

Achieving financial innovation through the cloud

Innovative banks who already understand cloud benefits are using this technology in a multitude of ways to understand risk, segment customers, track market movements, develop new instruments and ultimately gain a competitive advantage in an increasingly fierce market.

They are using the technology to process large volumes of information, reducing their time to market by rapidly creating and selling new and innovative financial solutions. Atom Bank is one example of an innovative bank turning to cloud to accelerate its digital transformation efforts. With cloud, the bank can provide more agility and scalability at a lower cost. The challenger bank operates in a very fast evolving environment and needs to take advantage of current innovation, whilst building for future speed by building more SaaS and creating an architecture that is resilient to future industry changes. Turning away from on-premise data centres towards the cloud has enabled Atom Bank to keep up with its tech savvy customer base by updating product app features or even creating entirely new services quickly and cost-effectively.

Other major players are also tapping the cloud to develop entirely new services. For example, Refinitiv recently launched its new Tick History database on Google Cloud Platform. The new offering allows Refinitiv's customers to access, query and analyse its extensive archive of pricing and trading data in much shorter timeframes, using Google Cloud's BigQuery.

Others leverage real-time market information streamed into large-scale, real-time databases and AI/ML models to quantify and cost risk. The time saved processing this information allows these banks to offer products at a much lower cost to their customers.

Traditional banks can also utilise the cloud to combat fraud and money laundering through AI and ML models, much like their challenger counterparts. Combining transactional and behavioural data can help more accurately detect fraud patterns and simultaneously avoid costly false positives. For example, using Google Cloud's BigQuery, Cloud Dataflow and Cloud Datastore to extract and store features for its model in real time, Monzo has already reduced its rate of fraud to an order of magnitude lower than the industry average.

Similarly, cloud-based technologies are being leveraged for banks' own risk-management to determine liquidity and exposure quicker, to carry out mark-to-market adjustments and for better accounting in general.

> *Conversations between technology providers and banks are now focused on what business problem the cloud can solve.*

HSBC is an example of a global bank - which is over a hundred and fifty years old - that is helping to better serve its customers using cloud technology. Using Google Cloud, HSBC can analyse petabytes of data in minutes. This allows the bank to calculate their liquidity position for scores of countries in a fraction of the time of their previous system. And HSBC can run much more complex financial crime analytics in a shorter time, while ensuring their data security and privacy.

It's not just banks and financial services companies that benefit from cloud-first banking, customers stand to gain the most. Cloud is transforming the technology ecosystem, and it's set to revolutionise the banking sector well beyond the core infrastructure. Now is the time for banks and technology companies to work together to take innovation of financial services and products to new heights for the benefit of consumers.

Chris Bartz

Chief Executive Officer & Co-Founder, Elinvar GmbH

A united Europe can become home to global leading fintech

Europe has the potential to establish itself as the ideal location and as an enabler for leading companies for fintech and the digitalization of finance, be it start-ups or established players. Digitalization and scalability are highly interdependent – so European policies need to enable both in order to ensure international competitiveness for European companies.

While it seems unlikely that, for example, another social network with global relevance will be founded and headquartered in Europe, there are massive opportunities in other sectors for Europe – particularly in fintech. Here Europe offers a unique combination of competitive advantages:

1) A proven track record in finance over many centuries and a high availability of talent with financial expertise.
2) A strong domestic market with a significant global market share based on volumes as well as on transactions, both key drivers for revenues.
3) Europe's outstanding reputation for trustworthiness and it's competence in data protection in particular, setting global standards in this area.

To leverage the potential for Europe and to become the major location for leading players in the fintech sector, the Fintech Council at the German Ministry of Finances proposed several key actions, published in the *Fintech Roadmap for Europe:*

1) Strengthening initiatives to eliminate obstacles to cross-border activities: we must ensure a single, strong and homogenous home market for innovative digital services to achieve the economies of scale needed to deliver customer benefits. Concrete obstacles to cross-border services like insufficient harmonization, gaps in the passporting system or discrimination against foreign IBANs, must be removed.
2) Establishing uniform European identification and authentication standards: user-friendly, uniform and standardised ID & KYC processes that are accepted in all countries without compromising on quality will provide customers with real access to the entire European market.
3) Creating a legal basis for comprehensive implementation of digital end-to-end processes: Digital identities and contractual agreements concluded digitally must be legally effective.
4) Harmonising standards and responsibilities to strengthen a single ecosystem: the financial market is turning into an ecosystem, where services are conducted through the cooperation of different market participants along the value chain. The historical principles-based approach needs to be developed further to meet the demands of an efficient ecosystem. Consistency between actual and regulatory responsibility, based on clear standards and interfaces, should be the core principle for all areas of the ecosystem. This must apply uniformly throughout Europe.

> *Europe has the potential to establish itself as the ideal location for leading fintech companies.*

5) Greater effort on the part of regulators and policymakers to promote innovation: successfully developing financial technologies will be underpinned by the pillars competence, networks, speed and security.
6) Enhancing customer confidence and customer responsibility with respect to data use: ensuring the data sovereignty of customers should be the primary consideration. The obligation to provide suitable interfaces should be extended to all providers across all industries and data management tools for customers should be supported.

Europe has the opportunity to actively shape the ideal framework to become home to global leading fintech companies. The moment to make this happen is now. ●

Does the EU have the players adapted to CMU objectives?

Philipp Hartmann

Deputy Director General Research, European Central Bank (ECB)

Financial structure, Capital Markets Union and Brexit

In this difficult hour for Europe and the world, it is challenging to still keep some focus on medium-term reform agendas. But as the corona crisis management has taken shape and as companies and households embrace the new ways of working and social interaction, we also need to get on with making our economies work better in the future. One European goal is to bring the Capital Markets Union to the next level. In fact, the corona crisis will create a lot of debt, so improving the functioning of capital markets is more relevant than ever!

The need for deepening capital markets in the European Union puts the spotlight on financial structure. Traditionally, bank-based and market-based financial systems have been distinguished, but more generally the financial structure describes the mixture of different financial markets and intermediaries. The March 2020 ECB report on "Financial integration and structure in the euro area" shows that the share of marketable instruments in total financing of euro area non-financial corporations stayed closely around 20 percent since 2002. In other words, securities market instruments, such as listed shares and debt securities, finance a much smaller part of euro area companies than non-marketable instruments, such as bank loans, trade credit or unlisted shares. The marketable part, notably public equity, is significantly smaller than in the United States or Japan, and not increasing. Private equity in Europe is large and rising. But compared to major advanced countries it is not helping many young and innovative firms to grow.

More dynamic equity financing would have at least two key advantages. First, equity investors tend to be more risk-loving than debt investors and finance more innovative companies. Second, recent ECB research suggests that economies with a greater equity share decarbonise faster. Hence, the next set of measures fostering CMU should have a particular emphasis on enhancing the share of public equity in company financing and on rendering private equity a more dynamic source of risk capital.

A number of public-sector policies would have sizeable effects on the demand and supply of equity in the EU. Pension reforms enhancing private retirement savings through diversified long-term investments would have the biggest impact. Second, improving financial literacy would be important, notably by introducing basic concepts in secondary schooling. Third, removing the tax advantage of debt would be very helpful. Fourth, stepping up public funding for life sciences and technology through universities and mission-oriented investments, respectively, could make a large difference. But also, adequate labour and product market flexibility and adequate levels of corporate taxation are important framework conditions under which equity-financed entrepreneurship flourishes.

At present global investment banks service about half of euro area companies' initial public equity offerings out of the City of London. Should regulatory equivalence with the United Kingdom not be ensured in the future, adequate relocations would have to take place or the EU to build its own capacity. It is important that the envisaged measures for advancing CMU take a forward-looking approach towards this and other implications of Brexit! ●

The views expressed are my own and not necessarily the views of the European Central Bank or the Eurosystem.

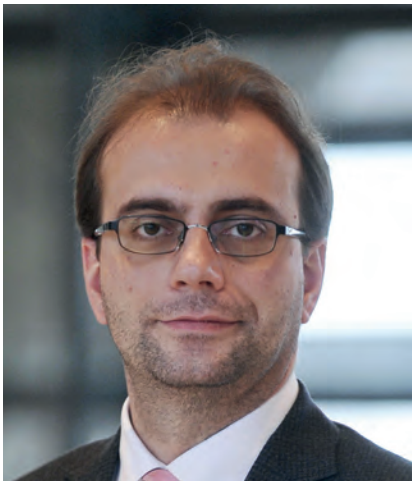
Sébastien Raspiller

Head of Department, French Treasury, Ministry of Economy and Finance, France

The EU needs strong players for achieving CMU objectives

As this article is being written, the Covid 19 crisis is hitting the European continent hard. It is above all a human tragedy and a terrible shock for the European economy. Europe has so far fed on crises in order to move forward. Hopefully it will also take advantage of this crisis to improve its functioning. It is also likely that in the aftermath of the crisis, a phase of economic reconstruction will begin, in which the problems of deepening the single market will become more acute.

As far as the Capital Markets Union is concerned, the Covid 19 crisis tends to demonstrate at this stage the difficulties to respond on a pan-European basis. Without going into an exhaustive review of the outcome of this crisis, several instruments are now sorely lacking to the European supervisory agencies (the so-called ESAs: namely EBA, EIOPA and ESMA). The 2018-2019 ESAs review will be reminded as a missed opportunity to prepare for this situation. Diverging views within the EU Council have prevented the ESAs from being given necessary supervisory tools. To quote only ▶



two instances, no-action letter powers are today lacking to selectively suspend the application of certain rules and direct supervisory powers would have been helpful to simplify reporting or limit pro-cyclical effect of the supervision in a uniform manner across Europe. The fact that the only coordinated market supervision measure adopted during the crisis was to lower the threshold for short selling reporting speaks for itself.

As for European private actors, the crisis overall means that capital markets will have to bring their contribution to fill the investment gap, in a context where possibly the banking channel could be hindered by the incoming prudential requirement. Three strategic fields provide valuable examples: insurance, investment banking and private equity fund.

In this regard, insurers, which are long-term investors by nature, are key to foster equity financing for our firms, and could be mobilized for our challenges for the future, such as digital and sustainable transition. Beyond, we need such long-term countercyclical investors to stabilize EU capital markets. The review of Solvency 2 can bring a significant contribution to this objective allowing insurers to fully play their role in the economy. This review should be led consistently with a reform of accounting standards, which have an unintended negative impact on investment in equities for insurers.

In the same vein, the CMU will not succeed without thriving European CIBs. This is all the more true as banks will play a central role in the recovery. It is therefore desirable to ensure that the transposition of Basel III standards takes into account what other jurisdictions will actually do, in order not to put European banks at a competitive disadvantage. Similarly, the use of the European framework for Simple, Transparent and Standardized securitizations (STS) needs to be encouraged in order to facilitate the management of banks' balance sheet. To achieve this, a review of impediments to the development of STS products should be carried out.

Private equity has gathered momentum, but it should scale up in the field of venture capital. Europe needs more funds that can issue larger tickets. We need to invest much more to stay in the innovation race – on artificial intelligence, on space, on energy storage. Hence it is crucial to promote a single globally recognized European standards. As for today, the EU labels a few funds invested in non-listed assets. Among them, the European Long-Term Investment Funds ("ELTIF") appears to be in the best position to emerge as the European standard, in a UCITS-like manner for listed assets. To encourage the promotion of the ELTIF as the European standard, further work is required to ease its passporting, alleviate its fiscal treatment throughout Europe and enhance the applicable regulation in order to facilitate flows of investments and disinvestments. ●

Stéphane Boujnah

Chief Executive Officer and Chairman of the Managing Board, Euronext

A new CMU: building strong EU public capital markets to finance the real economy

The current sanitary crisis is unleashing nationalistic tendencies that go beyond what is needed for the coordination of health measures at national level. Everywhere, we observe the temptation of "my country first", "my banks first", "keep the cash in my country for now" and many other signs of eroding European ambitions. In contrast, the Covid-19 crisis actually underlines how important public capital markets and CMU will be for the recovery, once it comes. But this will need to be a fundamentally different CMU. It will have to factor in the consequences of Brexit, recent central bank interventions and fiscal stimulus measures, as well as the very real risks of fragmentation of our capital markets.

In order to mitigate these risks, we must structure the new CMU around two ambitions.

First, a competitiveness ambition. If Europe wants to provide citizens, businesses and society at large with the tools to turn these challenges into opportunities, it needs a vibrant single market for financial services.

> *Europe must be a continent of strong and competitive finance makers, not an open territory of finance takers.*

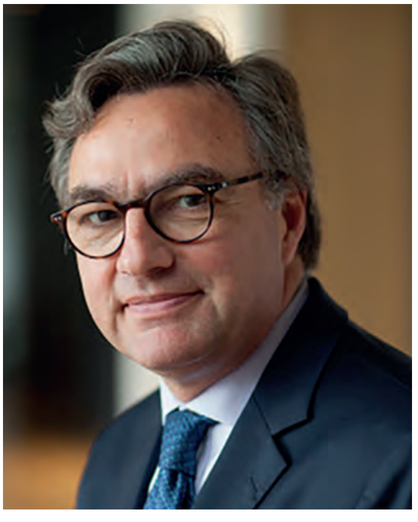
In this respect, Europe must be a continent of strong and competitive finance makers, not an open territory of finance takers. Therefore, every measure contemplated in

designing the new CMU must be assessed by a systematic "competitiveness test", which is more specific than the usual Commission impact assessments. This test should analyse - before new rules are introduced - whether they will make the EU's capital markets, financial institutions and infrastructure, stronger or weaker. If we want to unite capital markets, we need capital markets to be united. If this sounds obvious, then let's do it to stop the unilateral disarmament of the European financial system.

Second, a simplification ambition. Commission President Ursula Van Der Leyen has been clear that the regulatory philosophy of the Commission should be driven by the principle of "one rule in, one rule out". This simplification ambition is key to making the new CMU a success. Across the EU, investors, asset managers, issuers and all the other market participants need a pause in the continuous flow of incremental reporting obligations and operating constraints. Too often, such measures have a material impact on operations and profitability, without any tangible contribution to the unification of markets. Before proposing new rules under the new CMU, there must be a systematic assessment of what works and what does not work in MiFID II, MAR, Prospectus, Solvency 2, CSDR and the other pieces of regulation that have transformed markets over the past few years.

Many of the intended objectives of these regulations were not reached and some unwanted consequences have emerged, without the tools to mitigate the negative impacts on EU markets. This is a credibility test for the EU's regulatory ambitions. Either the new CMU will make all market participants' lives easier, with simpler rules, and trust in EU integration will grow. Or it will continue to add reporting obligations, follow a micro-regulatory approach, and market participants will turn to their national regulators and supervisors for more pragmatic solutions. Over-regulation will kill CMU and weaken Europe.

Euronext's ambition, by nature, is to be the backbone of the European capital markets. We want the new CMU to be a success. This is why we believe it is crucial that the new CMU be radical on these joint ambitions of competitiveness and simplification. ●



Jacques Beyssade

Secretary General, Groupe BPCE

EU competitiveness does include financial services

In Europe, banking groups are the main actors offering capital markets products to retail and corporate as permitted by the regulation. Banking and Capital Markets services are complementary and mutually reinforcing, each supporting the other by broadening the financing options available to their clients. The high level of financial regulation and supervision (AML, Prudential, Conduct, Anti-fraud etc.) is the result of a few crisis and 30 years of regulatory and supervisory efforts.

Banks contribute to the collective interest while expanding their expertise and their range of services including capital market solutions to corporate and retail clients. Banks are helping clients to diversify their source of financing or investments as advisers, issuers, information providers, brokers, market-makers, asset managers, insurers and payment providers. Banks are naturally very well placed, with their strong client knowledge and the development of long-term partnerships to educate them, to help them adapt to all stages of their development, advise them on the best way to enter and use capital markets.

European companies need, in their immediate environment, stable and long-term financing partners to preserve their competitiveness, especially in case of crisis. It is becoming increasingly clear that EU needs a strategic financial autonomy: make bolder decisions, retain talents and their added value & profits, build on stable, reactive, and efficient financing channels, with decision centers located near European companies and key markets infrastructures. Regulation should support this need, especially in the context of the Brexit. EU is losing the UK's well-integrated financial center and its key market infrastructures (LCH, LME, LSE etc.). UK is intending to diverge while keeping access as much as possible to the EU market. It is time for EU decision makers to make the competitiveness of our financial industry one of the top objectives of all EU financial services regulation in addition to address financial stability and client protection needs.

For instance, the implementation of global standards (e.g. Basel) should not undermine our current strengths and specificities (e.g. infrastructure financing). The calibration of the EU market access is also crucial: an interdealer regime is needed to access worldwide liquidity, while all significant client activities should progressively be performed from Europe. Each equivalence should remain unilateral, granted after a thorough review, assessing competitiveness, financial stability and client protection, requesting an EU entity above a certain volume of activity.

> *EU needs strong European financial players to build an attractive and sustainable CMU.*

EU market attractiveness deserves more national and supervisory convergences, a prudential recognition of the Eurozone as a single jurisdiction and well-known measures to improve the quality of the client marketing/selling process (MIFID, PRIIPS). It also needs to foster an EU digital and green market: we would suggest creating an EU database to cover among others, NFRD corporate requirements, while maintaining reasonable costs for users.

To build an efficient CMU at the service of its economy, the EU needs to improve the attractiveness of its market for end-users as well as to preserve the competitiveness of its financial actors. ●

Laurence Caron-Habib

Head of Strategy, Market Intelligence and Public Affairs, BNP Paribas Securities Services

EU Capital Markets integration: be pragmatic and focused for real achievements

Today there is full consensus that the CMU project did not deliver enough during the previous European Commission mandate: even if some progress have been made in some specific, but limited areas, much still needs to be done.

In view of ensuring that right measures will be embraced, it is important to understand why integration of capital markets has still to be pursued despite huge efforts already produced. First, national specificities due to multiple cultural, economic and historical factors, still exist between Member States and are deeply rooted. Many regulatory initiatives to reduce this fragmentation have been launched but are stil to be effectively implemented (such as the CSD Regulation) to produce their full effect and reinforce capital markets integration.

At the same time, we still see diverging interpretations in the effective implementation and local transposition phase. This is typically the case for reporting requirements where national discretion still prevails. The insufficient cooperation between national competent authorities on this part, plus the absence of truly convergent supervision in many instances, harms the emergence of a truly single market and consequently the provision of cross-border services.

Complexity of the regulatory framework is another impediment to the effective capital markets integration. Due to heavy and costly requirements that may need to be replicated across jurisdictions, few players are ready and properly equipped to engage in cross-border investments or provision of such services.

In that context what should be the main priorities of public authorities to enhance the role of capital markets in completing the CMU? First reconsider the list of identified obstacles to this integration and select pragmatically which ones should be tackled in priority. The approach must be selective and realistic to ensure real progress will be achieved. As an illustration, whereas practices for corporate actions and withholding tax should be further harmonised, harmonisation of securities law should not be pushed forward.

Next recommendation is about addressing the current complexity of some EU measures that impede the developments of cross-border activities across the EU. Some regulatory regimes should be reviewed to simplify current requirements and introduce further proportionality when relevant. The revision process launched for MIFID2-MIFIR is a great news in this respect provided that it does not deviate from the initial target of limited and focused review.

> *The approach must be selective and realistic to ensure that real progress will be achieved.*

It is also crucial that there is an increasing cooperation between national policy makers and supervisors. In that space, additional powers should also be given to the ESAs where transversal approach should prevail across the EU.

This comprehensive set of measures should result in preserving and even strengthening the competitiveness of the EU financial sector. In parallel, leveraging new technologies to solve some persisting integration issues should be given the required level of attention. Fostering harmonisation and standardisation, while ensuring level playing field between all players, should prevail in this new space to ensure a real transversal framework will emerge and that errors from the past will be avoided. ●

Improving the funding of innovative and growing SMEs

Roger Havenith

Deputy Chief Executive,
European Investment Fund (EIF)

Navigating the twin transition: late-stage financing

With the coronavirus pandemic unfolding, there is little doubt that we are facing a health and economic crisis of unprecedented proportions in recent history. This comes against the backdrop of Europe's challenges related to digitalisation and the transition to a green economy.

As usual, it is the smallest actors in the economy that will find it hardest to cope. This is where public interventions need to help innovative European SMEs not only to navigate the transition, but also to lead it. With limited public resources, crowding in private funds will be key. Financial instruments have proven to be very effective attracting private funding and catalysing investment in support of European SMEs and midcaps. Research has confirmed that companies supported by EU financial instruments have seen greater growth in sales, assets and employment. It is now a question of using these instruments to target the industries of the future, secure Europe's competitiveness and harness them to support our values, policies and standards. This entails expanding established mechanisms to support innovative SMEs throughout their lifespan.

For many years, lack of sufficient early-stage funding was Europe's main equity market gap. Public measures aiming at catalysing private investments have successfully narrowed this gap. A second market gap, however, persists: when successful start-ups need funding to support further growth. In 2018, European VC-backed companies received just EUR 15bn in late-stage financing, compared to 24bn and 57bn for their US and Asian counterparts. In the absence of financial support in Europe, SMEs will relocate to more favourable financial climates. US and Chinese investments in Europe have been increasing and foreign investors – often government-backed – have been eyeing Europe's most promising companies, enticed by attractive valuations and driven by strategic interests. The recent CureVac case is indicative of this trend.

If we are to create global champions, late-stage support needs to be reinforced. The proposed SME IPO Fund would expand the range of EU support measures and help complete the VC ecosystem. The issuance of new SME stocks on dedicated markets in Europe has never fully recovered since 2008: amounts raised went from EUR 16bn in 2006 to less than EUR 3bn in 2018. Addressing this later-stage financing gap would significantly improve the exit environment for investors. In a recent EIF survey of more than 300 fund managers, 40% identified the poor exit environment as their greatest challenge.

In parallel, as we look to support key sectors such as AI, block chain, space, skills, climate and social impact, we also need to make progress in completing the CMU, strengthening the single market, and ensuring solid trade defence mechanisms and a competition policy framework fit for purpose. Faced with many challenges at the same time, Europe needs an ambitious and common Europe-wide response that addresses the immediate threats for the health of our citizens and needs of the real economy. A response, also, that is fit to address the longer-term challenges: sustainable economic recovery and maintaining the competitiveness and innovation potential of our companies.

Financial instruments are not a panacea. But they can be a critical building block of such a response, helping to fund the opportunities that will propel European businesses to the forefront of a sustainable recovery. ●

Carey Evans

Managing Director, Global Public Policy Group, BlackRock

A roadmap to an improved funding landscape for SMEs and innovative and growing companies

Despite the perception that Europe loses its highest potential companies to the allure of US venture capital and the US consumer market, many exceptional young companies do indeed choose to stay put in Europe. Furthermore, Europe is home to a significant number of more mature SMEs who are, in many ways, world-leading firms.

These companies can be exciting investment opportunities for many investors, and the companies themselves should be able to benefit immensely from access to capital market funding solutions in complement to bank finance. The refocused CMU agenda should ▶

▶ provide means to better-connect companies and investors.

We see three areas of focus for promoting a healthy ecosystem for financing these companies:
1) Provide companies with pathways to grow;
2) Facilitate and ease the listing process, and;
3) Promote a wider and deeper investor base for small companies.

The debate over incubating growing business tends to focus on the 'funding escalator' – a linear path through various stages of specialist venture and growth financing, ending with an IPO. This path is increasingly out of sync with how many companies grow from a financing perspective. Companies can stay private or go public, depending on their needs, but the crucial point should be providing the opportunities for companies to grow as businesses.

The untapped potential for the Single Market to help firms grow into a pan-EU marketplace beyond their own national borders is significant. Working capital is a key ingredient for helping small companies of all growth aspirations and trajectories thrive, but it is often overlooked in the policy debate around supporting SMEs. Promoting additional sources of working capital to complement bank finance – such as non-bank lenders, or ABCP programmes – would help companies meet a range of ongoing financing needs.

"The refocused CMU agenda should provide means to better-connect companies and investors.

When it comes to the companies for whom listing can be an acceleration of their growth and funding aspirations, improvements to the listing process can be made. Since 2013, 40% of European IPOs have failed – largely due to pricing expectations not being met. Promoting direct listings where a firm lists without raising capital is a positive intermediate step where firms can build a track record as a public company, and investors can deepen their familiarity before the firm looks to raise capital. In a limited sample size in Europe to date, direct listings have resulted in companies finding it easier to eventually meet capital raising goals than they had previously attempted in their IPO processes.

In the medium-term, it is imperative to grow a specialist investor segment focused on small companies. Widening the investor base by exploring whether policy can bring in new investors or accommodate increasing interest from larger institutional investors is critical. For example, looking closely at structural barriers like accounting issues for insurers and pension funds that keep them under-allocated to strategic long-term asset classes like early-stage equity should be a key focus for policymakers. We see exciting possibilities as well for bringing investment strategies focused on exposure to a range of growth companies at different points in their growth trajectory – from early stage providing continuous investment through to their development into more mature listed companies – to certain types of retail investors with long-term investment outlooks. The ELTIF provides a unique platform to grow this market; targeted amendments to the framework could help facilitate this further.

A roadmap to grow sources of funding for many SMEs is more necessary than ever as Europe faces recovery from the economic impact of the current pandemic. The CMU High-Level Forum is looking at closely these issues and we are hopeful that the range of recommendations result meaningful benefit for European companies and investors. ●

Henry Erbe III

Global Head, Strategic Relationship Management and Public Policy, Fidelity International

Financing sustainable innovation in the EU with an Electronic ESG IPO Exchange

With the start of a new decade, the EU Commission needs to take bold action to relaunch the European Capital Markets Union (CMU) initiative with stimulatory policy and stakeholder engagement to drive SME capital formation in the "real economy". Since 2015, the core aim of CMU remains the same - strengthen capital markets, finance SME innovation and create jobs. In 2020, Europe also finds itself as the world leader in promoting Sustainable Finance and Environmental, Social & Governance (ESG) initiatives - a position that Europe must maintain.

Fidelity International recommends that the EU consider establishing a dedicated electronic ESG IPO exchange (ProjectE3) to power SME innovation, European economic growth and job creation. The time for the EU to innovate and differentiate is now. In non-EU markets around the world, SMEs have historically pursued initial public offerings (IPOs) to access growth capital they need to hire new employees, develop products, drive growth, ensure governance, as well as to expand their businesses in home markets and globally.

"The time for the EU to innovate and differentiate is now.

In addition, IPOs also provide pension funds, other investors and employees who receive long-term equity incentives, an opportunity to share in the upside of successful companies (studies show that 90% of job and revenue growth occurs after a company's IPO). The EU has not yet delivered on CMU and one negative result has been an 85% decline in European equity new issuance since 2005. The development of a dedicated electronic IPO ▶

exchange focused on sustainable initiatives will tackle multiple policy objectives of the Commission. It would enable SMEs access to growth capital, while putting into practice the objectives of the European Green Deal, Sustainable Finance and the CMU. With online issuance and electronic secondary market trading, an IPO exchange would also showcase Europe's evolution in the Digital Age.

In practice, we envisage a consortium of EU exchanges and market participants - bank underwriters and asset managers - developing an electronic IPO platform for ESG and sustainable SMEs with distribution to both institutional and retail investors as well as pension funds. In practice, SME eligibility for the ESG exchange would be determined using the EU taxonomy framework for the "Environmental" - and social, labour, tax and other policy frameworks for the "Social & Governance". A centralized ESG exchange and IPO platform would also encourage EU research excellence, market making, liquidity and attract non-EU issuers as well. Inspiration could be found with global regulatory initiatives for young emerging SME companies e.g. the US Emerging Growth Company IPO Reform, UK Alternative Investment Market (AIM), Hong Kong Exchange Innovation Lab & New Listing Regime - as well as many of the successful online financial lending and investing platforms.

EU regulators have an important role to play both in terms of overseeing the development of the platform as well as ensuring prudent governance and future supervision. With strong Points of View on IPO Reform, Sustainable Finance, Investor Education & Protection and FinTech Innovation, Fidelity International is ready to play an active role in creating an EU IPO Task Force to further develop this idea and others.

Oliver Gilvarry

Head of Markets & CMU, Ministry of Finance, Ireland

The importance of European retail investors & SMEs for European economic growth

The development of our capital markets will support the growth of our SMEs at different stages of their development, which in turn will ensure Europe has a dynamic and growing economy. In order to achieve the objective of developing a strong and deep European capital market to support our SMEs, we need to have the pools of monies to invest in such markets. The potential for increased participation of retail investors in EU capital markets is significant. In the EU, 30% of total household financial assets is held as cash and bank deposits, with wide differences between Member States.

To gain the maximum from increasing the level of retail investor participation in our markets, we need to ensure they can invest in products that support our SMEs along their growth cycle, from start-ups to becoming large corporates able to raise financing via global capital markets. This means ensuring that we have the range of financial instruments that SMEs can use to raise financing, such as through venture capital or private equity or debt issuance or IPOs. This will also benefit investors by allowing them to diversify their risk by investing in SMEs in different sectors, but also allowing them to diversify via investing in SMEs at differing stages of development.

Under the first phase of CMU we have made a number of amendments to enable our SMEs access additional sources of funding, we have amended the Prospectus Regulation, Market Abuse framework and EuVECA/EuSEF. We need to ensure the changes we have made across these different pieces of legislation, and others, are sufficient and are working in tandem with one another.

At the same time we need to consider, are we providing the correct amount and quality of information to investors to enable them make investment decisions? MiFID II has provided significant transparency to investors in the area of fees and we are seeing a change in behaviour as a result.

We need to build upon this by ensuring we are providing the right information in an understandable way for investors, along with aiming to reduce the burden on entities providing this information. By achieving these two objectives, we will help make access to our capital markets more efficient. The introduction of an additional class of investor under MiFID may be a way forward, but it must be designed in a way so as not to add more layers of regulation on firms or investors or lowering investor protection too far.

> *Another initiative could be to examine what needs to be done to improve take–up of the ELTIF structure.*

Another initiative could be to examine what needs to be done to improve take-up of the ELTIF structure. Its objective is to invest in debt and equity of non-listed companies. Therefore, it should be the ideal vehicle for Europe's SMEs during the early stages of growth. In the last phase of CMU we have made changes to the EuVECA/EuSEF structures; we should now do the same for ELTIF to help promote early stage investment in our SMEs.

To conclude, Europe has a growing and vibrant SME sector and we need to continue supporting it. This is even more important due to the impact Covid-19 will have on all our citizens and economies. Therefore the changes we need to consider in the next phase of CMU is how we increase retail participation, ensure we have the appropriate mechanisms for them to invest in our capital markets and that they and SMEs can invest and raise capital efficiently.

EUROFI MEMBERS

Allianz | American Express | Amundi Asset Management | aws | AXA | Bank of America Merrill Lynch

中国银行 Bank of China | Barclays | BBVA | BlackRock | Bloomberg

BME Spanish Exchanges | BNP Paribas | BNY Mellon | Groupe BPCE | Caceis Investor Services | Groupe Caisse des Dépôts

CaixaBank | cbp | Citadel | CLS trusted market solutions | CNP Assurances | Covea

Crédit Agricole S.A. | Credit Suisse | Deka | Deutsche Bank | Deutsche Börse Group

DNB | DTCC | Erste Group | euroclear Post-trade made easy | Euronext

European Bank for Reconstruction and Development | European Investment Bank The EU bank | Federated | Fidelity International | Finanzgruppe

Generali | Goldman Sachs | Google Cloud | Le Groupe Groupama | HSBC | ice

ING | Invesco | J.P.Morgan | KPMG | La Banque Postale | London Stock Exchange Group

mastercard | MetLife | Mizuho | Moody's | Morgan Stanley

MUFG | Nasdaq | Nordea | Nykredit | pwc

Raiffeisen | Refinitiv | Santander | SMBC | Societe Generale

Standard Chartered | S&P Global | State Street | SWIFT | Swiss Re | Tradition

UniCredit | UBS | VISA | WesternUnion WU | Zurich

Enhancing transparency in securities markets

Verena Ross

Executive Director, European Securities and Markets Authority (ESMA)

Less complexity, more transparency

Market transparency is a central pillar of the MiFID II framework and its effective application is critical for the development of competitive markets, ensuring informed investor decisions and allowing efficient allocation of assets. After two years of application of MiFIR, ESMA is assessing how transparency in EU markets has evolved and whether the new provisions have delivered on their objectives. In line with the review mandates embedded in MiFIR, ESMA published two Consultation Papers with analysis of the transparency regime applicable to equity and non-equity financial instruments and proposals for potential adjustments of the regime.

One important achievement of MiFIR is that national competent authorities and ESMA have more data at their disposal to check on market developments and assess how the law is working in practice. ESMA has made extensive use of such data in its consultation papers and the policy proposals entailed are based on in-depth data analyses.

Those analyses indicate that significant margin for improvement remains in many areas. For instance, on the equity side the majority of trading is not subject to pre-trade transparency (between 50 to 70% of trading in turnover), including on-venue trading where a large proportion of orders benefits from a pre-trade waiver (30% of turnover for shares and 50% for ETFs).

Regarding non-equity instruments, the level of both pre- and post-trade transparency appears to remain limited. This low level of transparency is partly due to the market structures prevalent in many non-equity markets but, in ESMA's view, also due to the way the MiFIR transparency provisions are designed. On the pre-trade side, MiFIR offers a broad range of waivers which, allow to be exempted from the transparency obligations under many circumstances resulting in real-time transparency being the exception rather than the norm. On the post-trade side, a complex deferral regime that is subject to national discretion has led to a patchwork of different rules applying in the Union.

Against this backdrop, ESMA is consulting on proposals reducing the complexity of the regime. As some examples, on the equity side, ESMA is considering to turn the double volume cap into a single cap, to simplify the applicable liquidity tests and to reduce the number of waivers.

For non-equity instruments, the main proposals include reducing the number of waivers and deferrals and establishing a streamlined deferral regime without national discretion.

Following the consultations, ESMA will analyse the feedback received with a view to aim at sending its final recommendations to the Commission in Q3 2020. ●

Anamarija Staničić

Head of Division, Policy and International Cooperation Division, Croatian Financial Services Supervisory Agency (HANFA)

Taking the long view in the equity market transparency debate

Now could be a good time to take a step back and asses if the transparency rules in the EU equity market would benefit from a larger overhaul, not just one that is Brexit related. Technology is distorting the application of MIFID/MIFIR rules, and data challenges in post-trade transparency will only get more demanding. Two years is not enough to assess if MiFID has led us in the right direction or not, but in the Brexit context, there is no question that a focused review is needed. Many of the requirements and thresholds in the current framework were calibrated to accommodate UK data. Consequently, rules like the double volume cap (DVC) cannot remain unaffected by the UK's departure.

The extraterritorial scope of the trading obligation carries its own pitfalls, with the potential to fragment liquidity and drain it away from EU venues. It is also difficult to assess how the systematic internaliser (SIs) regime will look like without the UK. It is a very fraught time to be a legislator, or ▶

an interpreter of rules, such as ESMA. So far, ESMA has concentrated on fixing the perceived failure of MiFID II to reduce trading on "dark" venues; through the use of waivers, the DVC, SIs, as well as on issues such as the trading obligation, and the (lack of) consolidated tape (CT). This is the technical side of the equity market transparency debate. And that is important – it truly is. However, we also need to look ahead, to the market as we want it to be, twenty years from now. Brexit is taking away what was a significant and integral part of the EU equity market for decades, but, at the same time, it is an opportunity for us to redefine what remains.

The real review of MiFID II should focus on the long view – how do we structure our equity markets to bring the most benefit to the real economy? How do we want our retail investors to predominantly access that equity market? Do we want to incentivise direct access, access through a financial product like an investment fund, or do we want to push a balance of both. This choice has an impact on the optimal structure of the transparency rules. We are currently trying to occupy the middle ground, which implies trade-offs in between types of access, as the optimal structure will at times conflict, favouring one type and penalising the other. Funds will benefit from a different set of rules than individual retail or even other institutional investors.

Waivers, thresholds, frequent batch auctions, SIs – they all have their benefits and drawbacks. Instead of focusing on the details, we should first ask how a rule or exemption incentivises our preferred policy choice. If a waiver or a venue of execution is justified in that context, then it should be permissible. The MiFID II framework also banked on being able to centralise all the data provided by Approved publication arrangements (APAs), but there is currently no CT in sight and one may be unlikely to emerge without some form of public sector backing. However, the viability of a CT may depend on legally obligating APAs to provide free data to the CT, or for a symbolic nominal fee. If so, a privately owned CT could be problematic, and a public infrastructure CT has its own challenges.

There is no doubt that we need to fix what Brexit broke, but we also need to acknowledge that some issues have not yet matured enough for long term policy decisions.

Stephen Berger

Managing Director, Global Head of Government & Regulatory Policy, Citadel

Achieving post-trade transparency in the EU non-equity markets

MiFID II laudably aimed to shine light on the historically opaque non-equity markets, including for both bonds and OTC derivatives. Regrettably, the post-trade transparency framework is not working as intended and has yet to deliver concrete benefits for investors. As the EU proceeds with the MiFID II review, addressing implementation shortcomings and establishing post-trade consolidated tapes for non-equities are necessary course corrections that will materially benefit EU investors, capital markets, and the broader economy.

Benefits of Post-Trade Transparency

Post-trade transparency, in the form of real-time public reporting of transaction prices and sizes, yields significant benefits. Myriad academic studies demonstrate that increased post-trade transparency in non-equity markets narrows bid-ask spreads and enhances liquidity. First, real-time public reporting empowers investors to accurately assess execution quality, demand accountability from liquidity providers, and obtain best execution. Second, real-time public reporting removes information asymmetries and allows all liquidity providers to better manage risk, and in turn, more confidently quote prices, commit capital, and warehouse risk across all market conditions. Third, real-time public reporting makes markets more resilient, especially in times of stress, by ensuring that new information is efficiently assimilated and reflected in current price levels.

Addressing Implementation Shortcomings in the MiFID II Post-Trade Transparency Regime

Unfortunately, to date, the accessibility and timeliness of the scarce EU non-equity post-trade transparency data that does exist is poor. First, very few off-venue transactions are subject to post-trade transparency requirements. For example, only approximately 5% of off-venue trading activity in OTC derivatives is currently subject to post-trade transparency requirements. Second, across bonds and OTC derivatives, even for on-venue transactions, four-week deferrals from public reporting are the norm, not the exception, primarily due to inaccurate liquidity assessments or excessively low size thresholds for trade deferrals. Finally, trading venues and APAs are not publishing post-trade transparency data free of charge after 15 minutes, as is required. Each of these shortcomings can be remedied and doing so will help set the MiFID II transparency regime back on course.

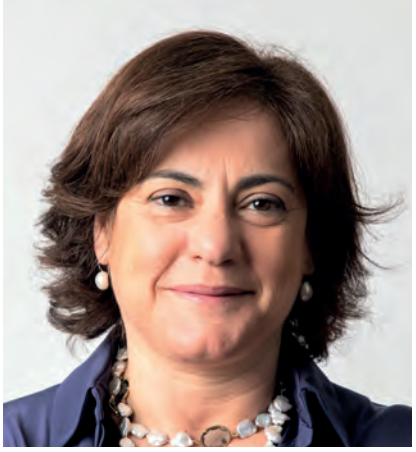
Establishing EU Post-Trade Consolidated Tapes for Non-Equities

In parallel with addressing the above issues, establishing real-time post-trade consolidated tapes for non-equities will ensure that EU investors can efficiently access and benefit from transparency data. The US post-trade consolidated tapes in each of the corporate bond, municipal bond, mortgage-backed securities, and OTC derivatives markets provide empirical evidence of both the value and viability of implementing post-trade consolidated tapes for non-equities. These consolidated tapes are each comprehensive, require mandatory contribution, disseminate information immediately upon receipt (both freely to the public via websites and via real-time data feeds at a reasonable cost), and feature targeted and limited deferral regimes for larger size block trades.

Conclusion

The MiFID II review process provides a critical opportunity to remedy identified implementation shortcomings and to establish post-trade consolidated tapes that together will put the MiFID II post-trade transparency regime for non-equities back on track, strengthening EU financial markets and improving conditions for investors.

Increasing retail investment in capital markets



Gabriela Figueiredo Dias

Chair, Comissão do Mercado de Valores Mobiliários (CMVM)

Retail investors are key to relaunch the CMU after the Covid-19 crisis

European capital markets development urgently needs a significantly wider engagement by retail investors, to equip the European Union (EU) with a financial system that can cope with the huge challenges we will be facing in the coming years. This is even more true given the deep, temporary, and hopefully short economic and financial contraction imposed by Covid-19. The flexibility and diversification of savings and credit alternatives offered by financial instruments to families and SMEs, but also to institutional investors, constitutes a significant advantage in supporting the recovery after the crisis, particularly in the context of a banking system under strain.

From a regulator's perspective, it is clear that, moving forward, financial supervisory and regulatory policies cannot focus mainly on market instruments and its infrastructure, as it has been the case in the first years of the EU's Capital Markets Union (CMU). More emphasis is needed on policies aimed at improving investor confidence in the capital markets, as there is no sound market without a wide investor base.

We should therefore focus on three dimensions: stronger financial literacy and investor protection, as retail investors are less prepared against bad market practices and have less capacity to recover from losses; fierce adherence to the highest quality and ethical standards among managers, especially in the financial sector; and on adopting a horizontal and cross-sectoral policy approach to markets, products and supervision that promotes a real single European financial market.

Regarding financial literacy, European initiatives have not been very expressive or effective. In what concerns investor protection, more has been done, and while trying to avoid overregulation, one should keep improving the legal framework and its application, as it being done regarding MiFID directive and legislation. Having said that, measures taken by ESMA, CMVM and other regulators to restrict CFD trading and binary options, or the use of its powers of product intervention, are part of the contribution we have given in this field.

When it comes to strengthening culture and professionalism of supervised entities and executives, the powers enshrined in MiFID, UCITS, AIFMD, EMIR, BMR and the Shareholders Directive allow regulators to assess and act on boards' culture, effectiveness and integrity and they should be strictly enforced. We should not refrain from acting.

Finally, to ensure a thriving European market for banking, investment, insurance and pension products, one should also level regulation and supervision accordingly, namely by aiming at a strong harmonization of the regulation across Member-states, including rules on ownership, insolvency and taxation of financial products.

The relaunch of the CMU after the Covid-19 crisis must be a priority, if we aim to regain our economies to full potential as soon as possible. For this to happen, the financial community as a whole needs to strengthen investor confidence in the capital markets by being more transparent and clearer regarding instruments, fees, rules and procedures; by being more focused on investors' needs; and by improving professional and ethical standards. ●

Niels Lemmers

Head of Public and Regulatory Affairs, European Investors/VEB

Never waste a good crisis to improve investor protection

The first few months of 2020 have been unique in the recent history of financial markets because of the speed of the correction. Almost all markets saw widespread sell-offs: equities, corporate bonds, commodities, gold and structured products. In the midst of promoting equity investments, the market turned south and had its worst performance in decades. And what years of legislative measures have tried to achieve happened in prompt reaction to the turmoil. In several countries more households started investing in equity. The WhatsApp indicator has arrived. Family and friends ask in WhatsApp groups how to start investing, because now you can get in relatively cheaply. And FinTech initiatives have made it even easier to start. If even the big drop do not keep households to invest for the longer term, then the tide may have turned. A proper, healthy equity culture is emerging. But at these junctures of market turmoil, unsuitable financial products are still being offered to households. Consequently, European Investors urge the reinforcement of investor protection rules. ▶

▶ Regulation has been implemented to ensure investors are advised on the benefits of equity investing with a long-time horizon. Unfortunately, investors are also buying complex structured products because they have been told that this would be a safeguard. Such advice is also based on regulations. Before the drop, the market was quiet and the delta was low so structured products were als quiet and reassuring. Then markets plunged precipitously, structured products fell even harder and their delta increased. The markets became more volatile and structured products were carried along with them. As soon as the barrier in the structured product is crossed, it is transformed from a capital-protected product into a unconditional loss. When unwinding the structured product, the issuer also needs to unwind the derivative hedges that were necessary initially. As derivatives markets became particularly illiquid, the cost of unwinding hedges increased, resulting in lower unwind prices for the structured product. Was this potential risk and painful scenario also properly explained to the end investor?

Was this potential risk and painful scenario also properly explained to the end investor?

Never waste a good crisis, they say. Retail engagement in capital market is important to build that proper, healthy equity culture in Europe.

Understanding the trade-offs in the market is just as important, however. If anything, the ongoing reviews of the MiFID II/MiFIR and PRIIPs regulatory frameworks need to address two issues. First, investors should always receive clear and unbiased investment advice, giving them a realistic picture of how financial markets and products function.

The financial education of households will take time, maybe decades, but it all depends on the information given before entering the capital markets. Second, some products are hardly suitable for investors. Certainly not in volatile markets like those we are currently seeing. Without wanting to diminish the investor's choice, we need to be cautious.

We can only have these products on the sales board if investors were told about the risks and returns of these products. Strong and enforceable regulation is needed in this area. Preferably steered by ESMA. European Investors calls upon the European Commission and Parliament to act swiftly.

Retail investors don't need a new 'CMU part 3'. They need reinforcement of the current regulatory framework and investor protection rules. ●

Javier Hernani Burzaco

Chief Executive Officer,
Bolsas y Mercados Españoles (BME)

Boosting the flow of retail investment into capital markets

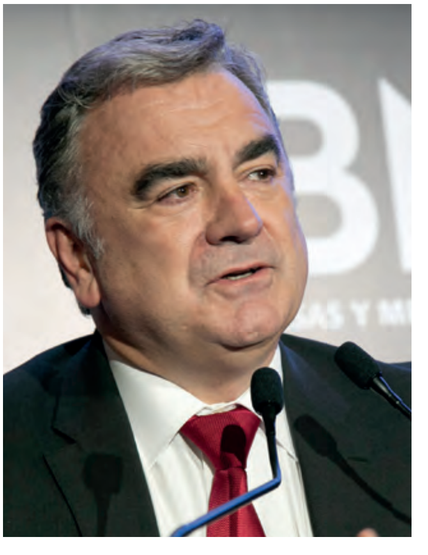
I head a financial group that has traditionally been proud of attracting high levels of retail investment.

Delving into my old papers while I was preparing this piece, I found that in 1998 a stunning 35,1% of our total market value of shares was in households' hands, ranking second after non-residents with a 35,9%, being the rest of holders banks, corporates, UCITS and public sector.

Unfortunately, the tune has changed since then, and in 2018 the figure had fallen to 17,2%, three points below ten years earlier. But there is always a silver lining: this figure shows a convergence with the rest of the continental exchanges –where direct retail investment has been lower– and almost 2,5 million Spanish households hold listed stocks within their portfolios.

There are several reasons that account for this trend. The most evident is the growth of investment funds. They provide fiscal benefits and are easily marketable by banks and, therefore, are a competitor difficult to beat. While 5% of the households' savings is directly invested in listed stocks, 14% is invested in funds. Market behaviour –particularly in sectors that whet retail investors' appetite, like banks–, also discouraged direct retail investment.

Finally, like the rest of Europe, Spanish financial sector is predominantly driven by bank products.



I mentioned above that there is a low level of retail investment across Europe. If we agree on the importance of retail participation in financial markets in order to release financial resources to fund companies' growth, we must admit that there is a European problem. ▶

If retail investors do not find easy ways to channel savings to productive investment, something is not working well in the Europe of the CMU.

In the CMU Green Paper, five years ago, the Commission stated that the development of capital markets in the EU required, among other measures, boosting the flow of retail investment into capital markets to diversify funding sources, which only could be achieved by enhancing the confidence of retail investors in capital markets and its intermediaries.

However, in the Midterm Review, four years later, the Commission acknowledges that engagement by retail investors with capital markets remains low, even though European households are amongst the highest savers in the world. The diagnose remains unchanged: most of the savings are held in bank deposits and accounts.

CMU must promote initiatives to increase levels of retail investor participation in public capital markets.

So, the measures have been insufficient and extra efforts are needed.

Maybe we should think carefully about the design underlying our European financial markets and particularly, financial regulation. Blue chips squeeze less liquid stocks out. Big issuers leave no room in the marketplace to small and medium companies.

Investment advice limitations also contribute to make SMEs invisible. Small intermediaries are disappearing, cutting the links with the local financial ecosystems. Costs and lack of transparency throw retail investors out...

Daniel Kapffer

Member of the Management Board, DekaBank Deutsche Girozentrale

CMU on the tipping point – retail investments are key for sound economic development of the EU

Participation of retail investors in capital markets is absolutely crucial for two reasons. On the one hand, households and other retail savers are the main source of long-term funding for the European economy. Without sufficient retail investor engagement, the high dependency on bank loans will persist. On the other hand, pension schemes will not provide enough retirement benefits to maintain living standards.

Retail investors need to build a significant component through capital markets investments. That's why the CMU aims to foster greater participation from retail customers.

There is no doubt – investor protection rules are fundamental to a healthy development of retail investments in capital markets. However, if they result primarily in significant obstacles, they will only prevent investments.

European regulation seems to follow the idea that the client should be able to have a deep understanding of his potential investments similar to that of his investment advisor. This results in a significant complexity even for a simple investment in a plain-vanilla instrument. Consequently, it not only scares the retail investor but also denies a fundamental principle of modern economies – specialization.

Short and easy to understand information is fundamental for investor confidence

The recent EU regulations Packaged Retail and Insurance-based Investment Products PRIIPS and MiFID/MiFIR have aimed at reducing complexity and helping retail investors better understand the key features, risks, rewards and costs of different products through a short key information document. However, MiFID and PRIIPS have not been harmonized, particularly as costs are concerned.

Another issue that has already been taken on by regulators are the performance scenarios that might lead to very misleading information on returns. Also, the high degree of standardization (for example SRRI) has replaced qualitative descriptions of the key risks. In the end retail investors receive less information that might even be more confusing.

...investor protection rules are fundamental to a healthy development of retail investments in capital markets.

Convenience stimulates confidence and reduces obstacles

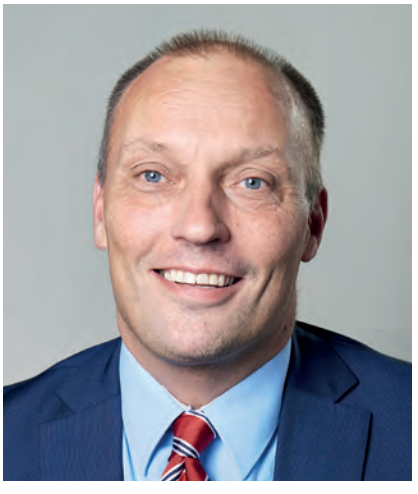
In order to achieve the two goals retail clients, need to invest on a regular basis into the capital markets. A one-time investment will not provide enough benefit. However, the rules set out especially in the MiFID/MiFIR for retail clients do not make a difference between different levels of retail investors. For each single transaction the whole set of requirements applies as it did for the last one even if this was in the same financial instrument.

Product information documents, ex-ante and ex-post cost statements and other complex regulatory rules are difficult to digest for retail investors and so discourages them from investing in financial markets. The lack of convenience leads to a lack of confidence, which affects not only direct retail participation in capital markets, but also the indirect forms of investment available through the variety of collective investment vehicles, like investment funds and pension funds, because it lowers the general investors' demand for access to capital markets.

In addition, the requirements regarding a timely provision of ex-ante information are a significant obstacle for investments via distance communication channels – in the age of digitalization a major channel. To ensure that these clients can use a means of distance communication effectively, and to ensure the timely conclusion of transactions, more flexibility is required.

The need to record phone conversations should be deleted especially because of privacy concerns for customers and the potential to impair the confidentiality of communication between investment firm and client.

Overall the regulatory approach has increased obstacles for retail clients to invest in capital markets while generating extremely high implication cost and increased cost of service for investment firms. The CMU can only evolve with investors who feel convenient and comfortable with their choices.



Paul-Willem van Gerwen

Head of Efficient Capital Markets Division and Trade Decisions Supervisor, Dutch Authority for the Financial Markets (AFM)

How a strong CMU could help reduce the fall-out of the Covid-19 crisis

In 2020 we saw global disturbance, as a result of the outbreak of Covid-19, resulting in markets being in turmoil. The current situation makes the case for a CMU even stronger – the need for highly integrated markets, with deep liquidity and available unlocked capital flowing freely. Facilitated by an appropriate set of rules this will offer companies various financing options by different types of market participants and financing providers.

A recurring key element to strengthen the CMU and increase funding options for companies across Europe is in achieving stronger participation among retail investors in capital markets and to provide them with more cost effective, simpler financial products and fair advice.

In relation hereto, building adequate and sustainable pension systems will help the retail investor to indirectly enter the capital markets by savings for his or her retirement. It would be worth exploring both public and private sector options to improve pension adequacy in member states with less developed pension systems.

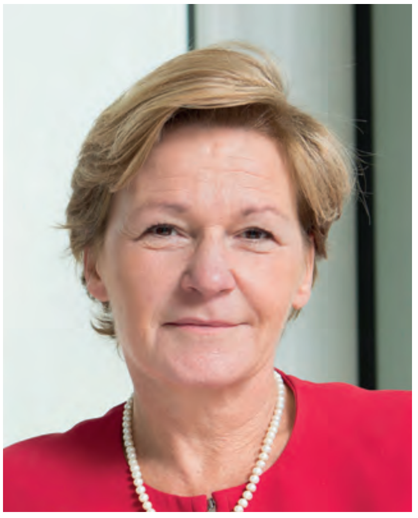
Also, further improved investor protection on EU level is required to achieve retail participation suitable for cross-border activities and open, transparent capital markets. In light hereof, the current EU passporting system, while being a cornerstone of the internal financial market, still faces challenges with regards to its implementation in the respective EU countries, as NCAs might hold different views on how to operationalize different EU legislation. This in turn can lead to 'jurisdiction shopping' where financial services companies seek the jurisdiction that applies specific requirements less intrusively.

Another key prerequisite for the CMU to become successful is the availability of transparent, integrated, standardized and highly liquid secondary markets covering various types of financial instruments such as equities and bonds.

As recent events have shown, market liquidity is essential in times of severe stress conditions as demonstrated during the current fall-out of the Covid-19 crisis, particularly for firms to retain access to funding. While the equity markets remained open and liquid (though highly volatile), the European bond markets came to a near-standstill with liquidity all but completely evaporating, particularly in the corporate bond market.

> *A fully integrated CMU is essential in avoiding future market collapses of any kind.*

In light of the strengthening of the CMU, it would be worthwhile to trigger a discussion on further improving the foundations of the EU-bond markets, particularly allowing for more open equity-like transparent market structures enabling cash-strapped companies with more direct access to retail savings. As the current primary and secondary bond markets are highly dominated by banks and the volumes of new issuances make bonds almost illiquid by nature, a necessary prerequisite would be further standardization of eligible instruments. This would enable access and liquidity provision by a more diverse landscape of market participants ranging from banks, professional trading groups, institutional and retail investors. Fundamentally, rather than central banks purchasing bonds of the balance sheet of banks to trigger the provision of credit, a more sensible approach could be offered by a strong CMU enabling firms to seek funding through a multitude of sources.



Judith Hardt

Senior Advisor, Better Finance

Retail investors are the key to the completion of the Capital Markets Union

There have been several attempts to build an integrated and resilient Capital Markets Union. From the perspective of Better Finance, the CMU project still lacks a solid individual retail investor base. 50 years ago, households were the primary owners of European stocks[1]. Today, foreign investors hold 32% of Eurozone listed equity, while households' ownership represents merely 11%. EU savers who have financial investments[2] gain exposure to the EU economy mostly indirectly, through packaged products (insurances, pensions, etc.), while listed shares account for only 4% of their financial balance sheets[3]. This is because investors are being "sold" packaged investments which are unfortunately often quite expensive and fee-laden products. They are very rarely offered 'plain vanilla' shares.

This development had a negative impact on Europe's capital markets. The market capitalisation of listed equities in the EU is almost three times smaller than in the US. SME fund themselves to a large extent through bank loans. In addition, dark trading increased despite the double volume cap introduced by MiFID II. About 60% of equity trading now takes place over the counter, versus 20% -40% before MiFID I.

To integrate capital markets, you need to integrate investor demand and retail user's perspective into the equation. Household savings are the foundation of any capital market. The first sentence of the Interim Report of the High-Level Forum on the capital markets union notes the following: Demographics clearly show that pay-as-you-go pensions will increasingly need to be supplemented by life-long intelligent saving and investing. If low interest rates persist in the long-term, savings accounts will no longer be a mechanism to increase the value of one's savings. This will only be achieved through a large-scale switch to equity investments.

It has become increasingly clear that the CMU must provide real investment opportunities for citizens to help them prepare their long-term needs, such as retirement, health and education.

To achieve this, investors firstly need easier access to specialised and truly independent expertise. The MiFID 2 and IDD reviews must eliminate inducements, at the very least for execution-only services, regardless if the investment products are insurance-based or not.

Secondly, Better Finance believes that it is paramount to develop and incentivize Employee Share Ownership. This could be the single most powerful driver to develop equity markets and culture.

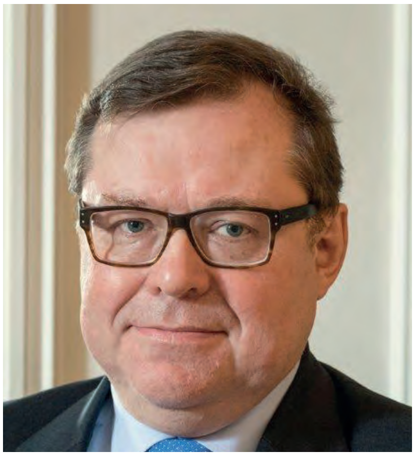
Thirdly, the PRIIPs framework must be reviewed as popular "retail" bond markets decreased by 70%, due to the new KID requirements.

Finally, individual investors need free and easy access to pre and post trade information on the listed securities they buy. All "retail" trading, must be brought back to regulated markets. ●

This article has been co-writen by Stefan Voicu, Research & Policy Officer of Packaged Investments, Pensions & Insurances, Better Finance

1. Didier Davydoff, Daniele Fano, Li Qin, 'Who Owns the European Economy?' (August 2013) Observatoire de l'epargne Européene, Insead Oee Data Services, p. 86, Annex 5, Table 3.
2. A survey in 10 large Eurozone Member States shows that, on average, only 43% of citizens do have financial investments, which speaks a lot about both households' participation in capital markets and financial inclusion; see European Commission, 'Study on the Distribution
3. See BETTER FINANCE's CMU Assessment Report 2015-2019, https://betterfinance.eu/wp-content/uploads/CMU-Assessment-Report-2019.pdf.

Challenges and priorities of the EU fund sector



Jean-Paul Servais

Chairman, Financial Services and Markets Authority, Belgium (FSMA)

Asset management regulation challenged by climate change and digital developments

Asset management in the EU is embedded in robust regulatory frameworks, including the UCITS Directive and AIFMD, to the benefit of the market operators and the investors. The success of the UCITS label is recognized both in the EU and abroad. Broadly spoken, AIFMD has worked well. Therefore, at this moment, there does not seem to be a need to launch a thorough AIFMD review, even if in some areas are welcome (e.g. in the area of segregation duties in case of delegation of the safekeeping of assets by the depositary). It is in the interest of the EU to have a stable framework for funds, while at the same time be responsive to new challenges, and this against the background of a prolonged low rate environment and of the corona crisis.

Firstly, asset management has a role to play in the European ambitions to achieve sustainable finance and, ultimately, the ambitious EU climate goals. In this respect, the EU should take a leading role, but should engage as well at a global level to contribute to the adoption of standards and practices that are internationally adoptable. Mobilizing sufficient private investment will not be possible without efficient capital markets and an important role for asset management. In this respect, enhanced transparency of sustainable features of financial products allows investors to identify viable sustainable investments. However, this evolution can give rise to investor protection concerns and can lead to greenwashing, especially given the risk of confusion about existing terminologies. Adequate disclosure and a harmonized taxonomy should address the risk that investors end up buying products, which are marketed as sustainable when in reality they are not.

Asset management also has to keep pace with digital developments in finance. Among the relevant developments are online digital services, robo advice, artificial intelligence and machine learning, each of which entail risks, benefits and opportunities. Regulators' strategy in relation to technological developments can be summed up by three actions: facilitate, monitor and supervise. Innovation hubs are possible channels to facilitate the contacts at an early stage between Fintech players and supervisory authorities and allow for better monitoring of the innovations. Supervision should ensure that innovation happens smoothly, so not to endanger consumer protection, fair and efficient markets or financial stability.

The increasing volume of the assets under management has finally led to a greater focus on asset management from a financial stability perspective. The FSB has issued recommendations intended to address financial stability risks from structural vulnerabilities associated with asset management activities that could materialize in the future. IOSCO has operationalized these recommendations concerning possible liquidity mismatches and fund leverage. Both aspects merit close attention at EU level. Although existing tools in the EU already address many of the macroprudential concerns, it is recommended that the relevant authorities review their existing regimes and consider making adjustments as appropriate to ensure potential financial stability risks are addressed in a forward-looking and internationally consistent manner. ●

Marco Zwick

Director, Commission de Surveillance du Secteur Financier (CSSF)

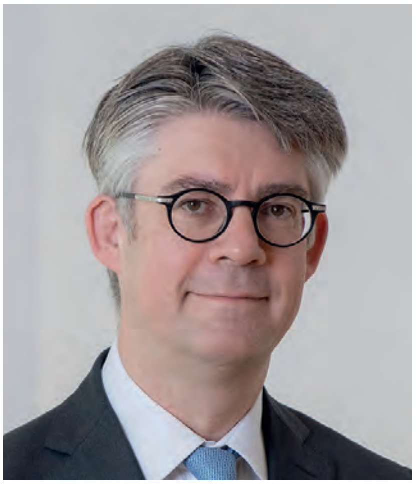
Key supervisory priorities for asset management

2020 key supervisory priorities include:

- Liquidity risks of investment funds, with a focus on UCITS;
- Cost and performance of funds, e.g. performance fees, closet index trackers;
- Data quality, availability and usage in relation to AIFMD, SFTR, EMIR;
- Review of AIFMD and related impact on UCITS;
- Sustainable finance and ESG;
- Anti-Money Laundering and Counter Terrorist Financing.

This article focuses on two of these key priorities: liquidity risk management and cost and performance of investment funds, which both are essential to maintain the highest degree of investor protection.

1) Recent isolated issues concerning liquidity risk as well as the strong growth of total net assets in funds have raised concerns with securities regulators. Hence, a closer look at the liquidity position of UCITS and AIF by investment fund managers and their supervisors is warranted. Having said that, we believe that the currently existing regulatory framework, which is based on international and European rules, overall provides for a solid basis to address liquidity risks in investment funds. Therefore, the primary focus for investment fund managers ▶



should be on adhering to those rules. Compliance with the rules is key to ensure financial stability, investor protection and the orderly functioning of financial markets.

With this objective, ESMA, together with National Control Authorities, has recently launched the Common Supervisory Action (CSA) on liquidity risk management. The CSA is a two-stage process starting with a data-driven screening on a large set of asset managers followed by a risk based, in-depth analysis on a smaller sample of managers, whose objective is notably to verify adherence to liquidity rules, to assess the existence of potential vulnerabilities and possibly suggest future improvements.

> *We monitor stability and the conditions under which the respective investment fund product and management passports continue to function effectively.*

2) Work in relation to costs and performance of investment funds is being performed at various levels:

- ESMA will soon publish its second annual report on costs and performances of retail investment products (including investment funds), produced under the EU Commission's Capital Markets Union Action Plan and aiming at facilitating increased participation by retail investors in capital markets by providing consistent EU-wide information.
- EU work in 2020 will also encompass the implementation of the forthcoming ESMA Guidelines on Performance Fees in UCITS and retail AIFs, which notably apply to actively managed UCITS.
- Work will continue on so-called "closet index trackers" which, according to their official documentation, claim to be managed in an active manner while in fact staying very close to a benchmark and, by doing so, overcharging for their investment management services. ESMA published a related statement in 2016 and at national level, and closet tracking remains a key issue for the CSSF in 2020. Following the initial investigations in 2016 / 2017, the CSSF thereafter continued work with a particular focus on enlarging the scope of the investigations.
- Finally, we monitor that, from a legal and regulatory perspective, the investment fund regimes remain stable and verify the conditions under which the respective product and management passports, which have contributed to the investment fund success story, continue to function effectively.

Verena Ross

Executive Director, European Securities and Markets Authority (ESMA)

ESMA's priorities for asset management in a changing world

There is no shortage of exogenous stress factors for the asset management sector currently, from the COVID-19 pandemic and its economic fall-out, the prolonged low-interest rate environment to the shift of money associated with the emphasis on sustainable finance. In addition, the asset management sector is facing evolving customer preferences, pressure on fees, and the growth of the passive asset management business model.

ESMA is monitoring these trends as well as the potential risks that may flow from them. As a result, one of ESMA's key priorities is liquidity risks in the asset management sector.

> *There is no shortage of exogenous stress factors for the asset management sector currently, from the COVID-19 pandemic and its economic fall-out, the prolonged low-interest rate environment to the shift of money associated with the emphasis on sustainable finance.*

ESMA launched on 30 January 2020 a Common Supervisory Action (CSA) with national competent authorities (NCAs) on the supervision of UCITS managers' liquidity risk management. NCAs will assess simultaneously whether market participants in their jurisdictions adhere to the UCITS liquidity rules in their day-to-day business,

on the basis of a common methodology developed together with ESMA.

The CSA should be seen in the context of ESMA's broader work on stress testing. In July 2019 ESMA published Guidelines on Money Market Funds' stress tests, followed by Guidelines on liquidity stress testing (LST) in

▶ UCITS and AIFs in September. On 5 September ESMA also published a stress simulation framework for investment funds, simulating a large redemption shock affecting investment funds and the subsequent impact of asset sales on financial market.

Regarding sustainable finance, ESMA recently issued its strategy. ESMA will promote ESG transparency by issuers and market participants to help investors to better understand the ESG impact on their investments and improve transparency on investments' contribution to a sustainable economy. ESMA will do this by:

- drafting technical standards and advice to the Commission (such as the Joint Committee technical standards under the Disclosure Regulation),
- providing guidance to market participants, building awareness, ensuring a common approach to supervisory activities on ESG,
- supervising transparency and application of relevant ESG requirements (relevant for credit rating and benchmark in the future); and
- developing risk identification of ESG factors, monitoring market developments of products with ESG characteristics and adjusting stress tests to incorporate ESG.

ESMA's renewed strategic orientation for 2020-2022 has emphasised the need to actively promote retail investor engagement in the European capital markets. Essential to these aims is ESMA's ongoing work on costs and performance of retail investment products, including the work on closet indexing and the technical work on the key information document for packaged retail and insurance-based investment products (PRIIPs).

Finally, the European Commission's process to review the AIFMD should not be forgotten. The AIFMD has formed an essential part of the European asset management sector legislation since it came into application in 2013. ESMA will ensure that lessons learned from the years of NCAs' practical experience supervising AIFMs are considered as the primary legislative framework is under review. ●

Simon Janin

Head of Public Affairs, Amundi

Key priorities and opportunities ahead for the European asset managers

While representing the second largest region in terms of assets under management, the EU still substantially lags behind the US. In 2020, the American asset management market size is expected to be roughly 52 US$ trillions, outperforming that of Europe[1], that barely exceed 29 US$ trillions[2]. Certainly, the mere quantitative comparison has its limits, as it does not take into account structural differences (notably the importance of pension funds in the US). This being said, a number of well-known reasons including the absence of a fully integrated market, the lack of supervisory convergence along with a burdensome regulatory environment, are some of the challenges to the development of asset management in Europe.

Proportionality, stability and predictability should then definitely inspire the EU regulation applied to the asset management industry. We need European players able to compete with the rest of the world in order to fully address the funding needs across the single market. Together with a strong focus on the importance of preserving a real level playing field with other jurisdictions, it is essential to ensure that we are properly mitigating market fragmentation and avoid as much as possible supervisory divergences orchestrated by various NCAs. In this respect, the forthcoming AIFMD review should be the opportunity to recognize the notion of EU group as a way to strengthen European asset managers' competitiveness and take the full benefit of the single market. This would definitely facilitate the exercise of the delegation or outsourcing of management between two entities belonging to the same group - provided that they are both subject to EU legislation. The AIFMD review could also allow for a clear recognition of AIFs that are UCITS-like and only address material shortcomings without reopening the directive's overall framework. Furthermore, great attention should be paid on the suitability of the current reporting framework.

The needs in terms of retirement savings and preference for the long term can also make the difference in the future. There is a tremendous opportunity to channel EU citizens' savings into long-term investment products. To achieve this goal, a balance has to be reached between risk-mitigation techniques and the need to invest in illiquid assets in order to achieve returns. Our industry together with policy makers must find solutions that certainly include a better consideration of the time horizon of investors.

> *The AIFMD review should be the opportunity to recognize the notion of EU group.*

Having all this in mind, the EU asset managers should be able to seize decisive opportunities in order to play their cards right. In this respect, sustainable investing has become a must-have for the asset management industry. The regulatory framework is evolving quickly, with the European Action Plan launched in March 2018 already taking effect, notably through the taxonomy, disclosures and benchmarks regulation. In parallel to the upcoming NFRD review, that should extend access to more comparable and reliable data, it is also essential to provide a European Ecolabel based on a scientific based taxonomy that properly includes transition activities. ●

1. Europe refers to the EEA + the UK + Switzerland.
2. The Cerulli Report, Global Markets 2019, p 40.

Jarkko Syyrilä

Head of Public Affairs, Nordea Asset and Wealth Management

Recovery from COVID-19 turmoil has to be EU's top priority in financial services

EU's short-term top priority in financial services needs to be supporting the economy to sustain and recover from the coronavirus crisis. Governments, central banks and other authorities need to do whatever it takes to overcome the economic impact of the crisis. New regulatory initiatives/ requirements should be delayed to help the financial industry to recover its operations and support its customers in full.

Looking beyond the current crisis, moving towards a carbon-neutral economy is a fundamental challenge facing the EU economy the next decades. The devastating economic impact of COVID-19 pandemic will add to the challenge. Both public and private capital will be needed to achieve the transition and asset management can be a key channel to convey private investments in a sustainable way. There is growing client demand for this and also lot of regulatory action.

What asset managers need in support of this development is clear standards and harmonization that will support the growth and mainstreaming of sustainable finance. Avoiding labels and frameworks becoming too niche and hindering product development is key. Regulation needs to be meaningful, requirements clear and non-duplicative and implementation schedules realistic. Key is also to have clearer ESG data standards so asset managers can assess the investee companies properly and fulfil all the new requirements.

EU asset management regulation is very mature and successful in global comparison, especially UCITS has become a global gold standard which has to be preserved. No major overhaul is needed. The planned reviews of the UCITS and AIFMD should be evidence-based, carefully targeted and aimed only at addressing material issues that cannot otherwise be addressed through supervisory convergence.

Lot of focus has in recent years been devoted by the stability regulators on liquidity of investment funds. The COVID-19 market turmoil is now stress testing the current rules in real life. EU regulation already provides a proper toolkit for asset managers to manage the liquidity of their funds, but these tools are not evenly allowed by the national regulators. A big step forward would be ensuring that these liquidity tools are available in all EU jurisdictions.

Many EU regulatory measures have in recent years been adopted impacting indirectly asset managers, most prominently MiFID II which is having key impact on distribution models. With the review of MiFID II now commencing EU has the opportunity to correct the problems that have arisen for the industry to be able to serve its clients properly. There are certainly pressures to amend the client classification framework to create a category for semi-professional investors and to simplify the costs and charges disclosures.

EU action is needed to establish a proper framework for long-term investment for retail investors, allowing them to commit a greater part of their savings into less-liquid investments. It seems we will be in the low yield environment for long so Europe needs new kinds of products to give retail investors adequate returns. ELTIF was a laudable idea but has not been taken up by the market. We need to analyse carefully what went wrong and how to create a workable framework on less-liquid assets for retail investors to ensure they have all the means they need to achieve a proper asset allocation for their savings.

The European economy faces many short-term and long-term challenges. By working in constructive dialogue policymakers and the industry can ensure that asset management continues to help economies and citizens to overcome the challenges they face in current crisis and in the future. ●

Stéphane Janin

Head of Global Regulatory Development, AXA Investment Managers

How circumstances should lead to asset management regulation adaptation?

At the time of drafting of this article, it is difficult to anticipate what the market situation will be when it is published. However, some lessons can already be drawn – possibly leading to practical actions by policy-makers and regulators.

First, the prompt spreading of a natural virus and its consequences were difficult to anticipate. Since the 2008 crisis, the work carried out by supervisors was mainly targeting the risk of re-occurrence of a similar event. The actions were not so much taking into account externalities such as sanitary risks and their impacts on finance. Probably no one can be blamed for that, as by definition a crisis occurs where you have not anticipated it.

So the point is not to anticipate any crisis for ever – which would be ▶

▶ pure utopia – but more to set the right tools to manage in practice the consequences of an unpredictable shock.

The current EU legal requirements work well. AIFM and UCITS Directives require fund managers to be licensed, monitored and if needed sanctioned by NCAs. The role of ESMA to facilitate the coordination among NCAs is also positive to facilitate convergence at EU level.

However, the current exceptional context demonstrates the insufficient requirements applicable to other players in the value chain or the uncertain application of best practices and rules among Member States.

First, regarding risk management, fund managers are currently lacking information from distributors on the detailed profiles of fund investors. ESMA identified the need for fund managers to anticipate investor behaviors, through its "Guidelines on liquidity stress testing in UCITS and AIFs" issued in September 2019. But to date, distributors do not provide on a free-cost basis for such investor profiling.

Still regarding risk management, many Member States have not introduced the complete set of fund liquidity management tools available in other Member States, e.g. swing pricing. This is regrettable as already 2 years ago, IOSCO issued a report recommending NCAs to introduce the widest range of tools: « IOSCO expects that authorities will actively promote the implementation by responsible entities of the 2018 Liquidity Recommendations".

Set the right tools to manage in practice the consequences of an unpredictable shock.

The fund industry reminded such issues to EU authorities in two AMIC/EFAMA public reports on fund liquidity, already in 2016 and more recently this year. We wrote: "We note that the operational tools listed, such as swing pricing, for example, while not mandatory under the AIFM or UCITS frameworks, are useful liquidity management tools for fund management companies. ESMA could encourage the NCAs in certain EU Member States to consider broadening the range of available tools, thereby ultimately contributing positively to the management of liquidity risk."

Last, the Commission should use its powers at Level 4 to ensure the application of existing EU rules across Europe. For instance, we are still lacking the first ESMA report on AIFM measures and sanctions, although required by the AIFM Directive almost ten years ago.

These practical actions by ESMA and the Commission towards Member States should be taken as top priorities, in the general interest of financial stability and investor protection – before deciding to launch any legal revision of the AIFM rules. ●

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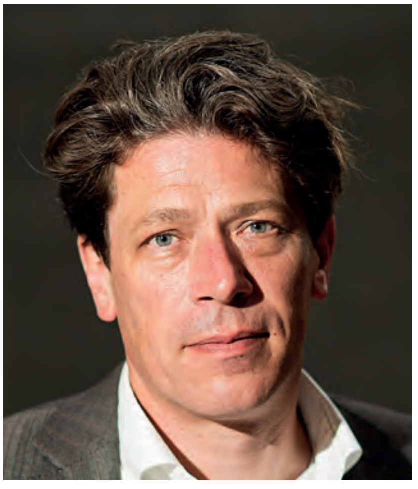
Relaunching securitisation in the EU



Paul Tang

MEP, Committee on Economic and Monetary Affairs, European Parliament

Securitisation done right

Securitisation done right has benefits for lenders and institutional investors alike. Securitisation done wrong, however, can amplify economic crises and bring the global economy to its knees. The EU's securitisation regulation created a standard that allows for the benefits of securitisation, while avoiding the pitfalls. Under the right economic circumstances and with the endorsement of regulators, securitisation can play a pivotal role in recapitalising banks in the post-COVID, Basel III regulatory environment.

Pooling illiquid assets into tradable securities allows lenders to increase lending capacity while transferring risks to investors according to their preferences. It is important however, that these risks do not remain in (the systemic part of) the financial sector, so that overall stability is guaranteed. Besides, when low trenches of asset-backed securities are repeatedly packed in collateralised debt obligations, it quickly becomes impossible to analyse the product's creditworthiness. Since such CDOx products helped propel a US housing crisis into a global financial meltdown, it is only right that a certain stigma is attached to – complex – securitisation.

When, after the financial crisis, European securitisation remained subdued, the European Institutions reset the market through a regulatory framework for "good" securities. It set rules on due diligence, risk retention and transparency for all securities, and enabled the identification of simple, transparent and secure (STS) products. With level-2 measures published, we now see the first early results. In 2019, 143 transactions were notified to ESMA as STS. In the first two months of 2020 over 30. STS is thus a workable standard, allowing the reaping of securitisation's rewards, without suffering its drawbacks.

Expansionary monetary policy means the use of securitisation to increase lending capacity is limited. Why pay fees to a range of credit rating agencies, underwriters or credit enhancers, when you can secure cheap capital with the ECB? But, with EBA estimating that banks need over €100bn to fulfil Basel III requirements, securitisation can help reduce risk and improve one's capital base. Given the sector's efforts during the current COVID-19 crisis, this amount is only set to increase. Securitising outstanding loans will be essential to reach Basel III standards.

However, the EU regulatory environment means that using STS securities is not yet fully rewarded. For example, the standards for other financial products have not caught up with those for securities. Products such as covered bonds lack securities' transparency and due diligence requirements. With ambitious regulation on these products, the EU can set off a race to the top while guaranteeing a level playing field.

As EU we can be proud to have eliminated the most stringent risks associated with "bad" securitisation while creating the global standard for the "good" kind. Yet, the combination of expansive monetary policy with an imbalanced regulatory environment means the EU is not fully capitalising on this standard. With lenders seeking the capital base increase that securitisation provides, this is something to set right. Upcoming reviews of financial legislations provide a good opportunity to do so. ●

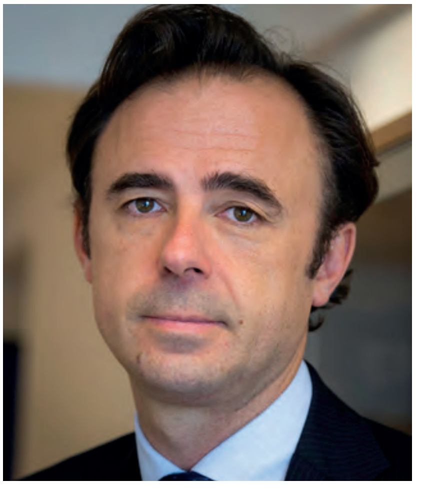
Martin Merlin

Director, Banks, Insurance and Financial Crime, DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

The STS label has kicked off to a good start, but fine-tuning needed

Securitisation plays a key role in the Capital Markets Union (CMU) creating a bridge between bank lending and the CMU objectives. Overall, it is expected to contribute significantly to unlocking the benefits of the Single Market for EU businesses and households by providing more innovative, sustainable and diversified sources of funding. When soundly structured, which was one of the aims of the overhaul of its legislative and regulatory framework, securitisation allows banks to transfer assets to institutional investors and free up capital for new lending, while providing markets with a broader scope of investment opportunities.

The EU securitisation market got off to a slow start in the beginning of 2019, ▶



in the first months of application of the new framework, but activity picked up thereafter. The authorisation of third-party verifiers seems to have had a very important positive effect on the STS market, helping operators navigate the new framework. The first STS deal, a private RMBS securitisation, was notified to ESMA on 22 March 2019. Thereafter, originators started 'taking the plunge' and nearly 200 STS deals were notified to ESMA by mid-March this year.

It is early to make definitive conclusions about the state of the market and the impact of the new framework after just one year of application. The take-up of the STS label does point to strong demand among investors. Thus, the new label has helped to reduce the stigma among investors. However, the fact that we have not yet seen a broadening of the investor base and, more generally, a significant rebound in the securitisation market suggests that additional action might be needed.

The European Commission is finalising the Level 2 measures which, together with the Q&As by the ESAs, should dispel any lingering uncertainty about the application of the new rules. To support issuance, the Commission will explore extending the STS label to synthetic deals and facilitating securitisations of non-performing exposures, based on input from the EBA.

The upcoming comprehensive review of the securitisation framework, mandated to take place by January 2022, will look carefully at all of its aspects, including the Level 2 measures. Moreover, The CMU High Level Forum is preparing recommendations with the objective to relaunch and scale up EU securitisation as it can bring considerable benefits to the European financial system.

> *The new label has helped to reduce the stigma among investors. However, additional action might be needed.*

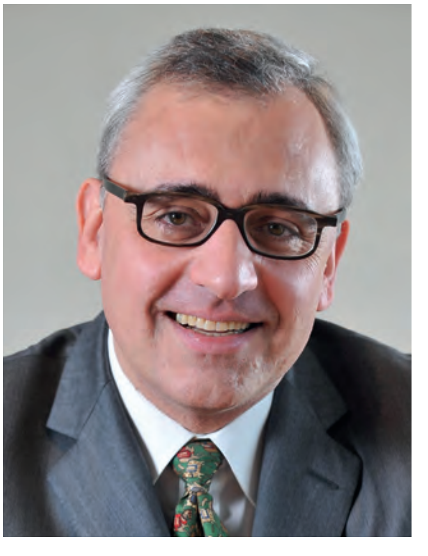
With regard to the capital treatment of securitisation exposures, there is widespread acknowledgement that it needs to be adapted to the specific features of non-performing exposures. The EBA and BCBS are already actively working on possible adjustments in particular to the formulaic approaches for the calculation of capital charges. Another area requiring potential improvement is that of the recognition of significant risk transfer where stakeholders claim a more uniform interpretation and application of CRR provisions by supervisors.

The EBA is expected to produce a report by the beginning of 2021 that could serve as a basis for a delegated act by the Commission. The Commission is also working on the adoption of the RTS that will allow a more widespread use of the Internal Ratings Based Approach, the most risk-sensitive method for the calculation of capital charges for securitisation exposures.

Supporting the EU securitisation market remains a priority for the Commission. The aim of the securitisation framework is that the market functions on a solid and sustainable footing, subject to clear criteria and appropriate supervision and prudential rules, in order to ensure that the securitisation duly contributes to the CMU objectives. ●

Alexander Batchvarov

Managing Director, Bank of America



STS: unleasing the potential of EU-27 Securitisation Market

In each of the last two years EU-27 issued €370-€400bn of covered bonds, placed €7-€9bn of RMBS, and €50-€60bn of other securitisation bonds. The STS introduction in 2019 did not boost issuance volumes; it is unlikely to do so in 2020. By way of comparison, securitisation represents 12.5% of GDP in the US (excluding GSE securitisations) and 12% in the UK vs. 3% in the EU-27; covered bonds represent 21% of the EU GDP and 4% of UK GDP.

Securitisation represents 6% of all green bonds in China and about 1% in the EU. Many factors affect securitisation activity: ECB policy, non-bank lending, bank capital needs, but they alone cannot explain the low utilisation of securitisation in EU-27. Securitisation has an important role to play in the EU-27. The introduction of Basel 3 will increase bank capital requirements by an estimated EUR100bn.

> *The securitisation regulatory regime must be realigned with that of other fixed income sectors.*

The focus on sustainable finance and ESG impose new criteria on bank balance sheets. Banks must address the new capital and financing needs through sale of assets, balance sheet optimisation and/or securitisation. Banks offload assets to asset managers and finance companies, which in turn finance their acquisition via securitisation. If half of the bank capital increase is due to residential mortgages and half of that is addressed via securitisation, then a need for EUR800bn of RMBS issuance in the next 5-10 years will arise.

Funding the EU Green Plan also needs a functioning EU securitisation market. EU-27 needs to scale up its securitisation market, but it remains underutilised. ▶

▶ With the introduction of STS in 2019 the regulatory capital for securitisation increased on average under CRR, remained unjustifiably high under Solvency 2, there was no change in liquidity and repo treatment of securitisation bonds, and detailed disclosure and due diligence requirements (unparalleled in any other fixed income sector and in any other jurisdiction) were imposed. The calibration of regulatory capital for EU securitisation does not reflect its historical performance and is subject to non-neutrality.

The securitisation regulatory regime must be realigned with that of other fixed income sectors, especially loans, corporate and covered bonds. Several changes can be introduced in the near term to allow for the EU securitisation market to scale up and to provide the much needed support for the EU economy and banking sector: A/ Modify securitisation capital and liquidity treatment under CRR (e.g. LCR treatment, p factor, WAM); B/ Recalibrate capital treatment for securitisation for insurers under Solvency 2 in line with covered bonds for STS and corporate bonds for non-STS securitisations; C/ Simplify significant risk transfer requirements for cash and synthetic securitisations, expand the STS for synthetics beyond SMEs to include other granular exposures. D/ Differentiate between disclosure and due diligence requirements for public and private securitisations applying proportionality and allow for longer-term use of ND fields.

EU-27 securitisation market has a crucial role to play in deepening of CMU, in greening the EU economy, in strengthening bank balance sheets while introducing new capital and sustainable finance requirements. Key measures necessary to ensure that it fulfils that role lie in the hands of the EU policymakers. ●

Philippe Bordenave

Chief Operating Officer, BNP Paribas

Five "game-changers" to scale-up securitisation in Europe

Following the implementation of a burdensome STS regime, European issuance dropped to EUR 131 bn in 2019[1], down by 6% y/y, compared to USD 2.5trn in the US. As long as such a gap exists, every banking regulation will have a disproportionate impact on the EU compared to the US.

While the goal should be to develop pan-european home loan securitization, this can only be a mid-term project. In the short term, the current EU prudential framework should be urgently adjusted, with five regulatory changes needed as "game-changers" to scale-up the EU securitisation market:

1. Unlock the Significant Risk Transfer Assessment process

This process is essential, for issuing banks to benefit from a reduction in capital charges, commensurate with the risk transferred to the market. While the CRR defines specific quantitative and qualitative criteria to meet this Significant Risk Transfer, the additional discretion provided to competent authorities has turned into a major obstacle, with multiple metrics added.

- When the level 1 quantitative and qualitative criteria are met, banks should be considered as achieving significant risk transfer, with no additional supervisory scrutiny.
- Such simplified rule would still result in a very prudent framework, given the conservativeness of the RW of the retained tranches, even after the proposed recalibration as per below.

2. Recalibrate capital charges applied to senior tranches, in line with their risk profile, for originating and sponsor banks

The implementation of the STS framework aimed at defining strict criteria for a safe securitization, but instead of reducing the RWs of the senior tranches, it has actually increased them. Also, it did not address the issue of "non-neutrality", whereby the cumulated RWA of securitized tranches is between 2 and 4 times the RWA of the loan pool prior to securitization, making securitization economically unviable.

- The non-neutrality should be reduced by recalibrating the "p factor" that drives this multiple
- The RW floor applied to senior tranches should be reduced for originators and sponsors, as they have a perfect knowledge of the securitized pool.

3. Enlarge STS benefits to synthetic securitisation beyond SMEs

Synthetic securitizations are easy to execute, standard, and very useful to transfer risks and release capital. Protection sellers are highly specialized, and they perfectly understand the risk.

- The same RW should apply as for cash securitizations.
- STS synthetic securitisations scope (currently limited to SME's) should be extended to all corporates and retail exposures.

4. Upgrade eligibility of senior STS tranches in the LCR ratio

The revision of the LCR Delegated Act has not improved the treatment of senior STS tranches.

- Senior STS tranches should be promoted to Level 1 (for residential and auto loans, the most liquid types of securitization) and Level 2a (SME loans and other ▶

consumer loans), with same haircuts as for covered bonds.

5. Review the Solvency II calibration of senior tranches

Insurance companies should be able to invest in senior tranches instead of investing directly in the underlying assets with no credit enhancement.

- The credit spread shocks applied to senior STS securitization positions could be aligned with those applied to the bonds and loans.
- Finally, removing ESMA disclosure constraints on private transactions also appears as a pressing issue.

Those five measures are needed to rebuild a functioning ecosystem for securitization, allowing for a significant scale up of issuance, far above recent levels, which represent only about 1% of EU banking assets. Given the upcoming Basel III regulatory pressure, the need to finance the energy transition, while reducing the over-reliance on bank funding, the EU should take prompt action to significantly scale-up the securitization market. ●

1. Figures based on SIFMA, BNPP data. European securitisation placed issuance (EUR bn); scope: ABS, CDO/CLO, CMBS, RMBS, SME.

Dimitris Zafeiris

Head of Risks and Financial Stability Department, European Insurance and Occupational Pensions Authority (EIOPA)

EU regulation supports functioning of the securitisation market in a prudent way

A well-functioning securitisation market improves the funding capacity of the real economy and contributes to completing the Capital Markets Union. At the same time, securitised assets may provide an alternative investment opportunity to insurance and reinsurance undertakings, which need to diversify their portfolios in a low yield environment. As institutional investors, insurance and reinsurance undertakings should be fully integrated into the Union's securitisation market.

It is important that Solvency II, as a risk based regulatory framework, provides a sound basis for (re)insurers to invest in securitisations without jeopardising the regime's prudential risk-based nature. In 2013, EIOPA proposed a solution to reduce capital requirements for specific securitisations by a more granular treatment of securitisations. For identifying less risky securitisations, EIOPA developed a set of criteria related to the structure of securitisations, the quality of the underlying assets, the underwriting processes and the transparency for investors.

The proposal was based on analysis which had shown that those types of securitisations meeting a set of quality criteria had a good track record of performance. From a supervisory perspective, EIOPA proposed to apply lower capital requirements to those instruments.

> *EU regulatory frameworks including Solvency II support the functioning of the securitisation market and long-term growth objectives in a prudent way.*

To ensure a sound recovery of the EU securitisation market after the financial crisis, in 2017 a new overarching securitisation framework was introduced. The new framework includes criteria to identify simple, transparent and standardised ('STS') securitisations and a system of supervision to monitor the correct application of those criteria by originators, sponsors, issuers and institutional investors.

The Regulation also provides for a set of common requirements in relation to risk retention, due diligence and disclosure for all financial services sectors[1]. To avoid double regulation and for reasons of clarity and consistency, the Solvency II framework was adjusted accordingly in 2018. The amendments to the Solvency II Delegated Regulation[2] introduced a more risk-sensitive calibration of the solvency capital requirements for STS securitisations held by undertakings.

The level of the calibration and the risk sensitivity across tranches was aligned with the features of STS securitisation, and is now consistent with the prudential requirements developed for credit institutions and investment firms. The objective is to provide the right incentives across different forms of securitisation investments and allow for better alignment between risk and capital management. A more detailed review of the Solvency II reporting and disclosure requirements will be part of the 2020 review. ●

1. Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation.
2. COMMISSION DELEGATED REGULATION (EU) 2018/1221 of 1 June 2018 amending Delegated Regulation (EU) 2015/35 as regards the calculation of regulatory capital requirements for securitisations and simple, transparent and standardised securitisations held by insurance and reinsurance undertaking.

Jan-Peter Hülbert

Managing Director,
True Sale International GmbH

Securitisation and STS: contribution to financial markets stability in the EU

In order to asses this question, the review of the last financial crisis provides two important insights: First, default rates of European securitisations were consistently low and did not cause losses and bank bailouts.

Rather, securitisation as a highly collateralised financing tool has contributed to financing the real economy in times of crisis. Secondly, the European legislator and the ECB have rightly adopted a number of important regulations in the period 2009 to 2011 that will prevent securitisation types that were responsible for the financial crisis 2008, especially: 5% risk retention, loan-level data, no originate-to-distribute models and ban on re-securitisation.

Now how is securitisation used in practice and what impact does the new EU Securitisation Regulation (applicable since 2019) make? Firstly, banks can provide its customers with solutions for funding and capital relief, products employed are public term ABS with placement to investors, and private securitisation financed via bank balance sheets and including ABCP programs (Asset Backed Commercial Papers). Secondly, banks securitize own assets from their ordinary course of business to achieve funding and capital relief. This again involves term ABS as well as private, bilateral securitizations for risk transfer. This differentiation is necessary in order to understand what contribution the EU Securitisation Regulation has made and what problems still need to be solved.

The EU Securitisation Regulation overall and also the STS criteria for simple, transparent and standardised securitisations as a quality segment distinguish between ABCP and non-ABCP (i.e. term ABS). Term ABS issuance of €220bn in 2019 has declined by ca. 15% compared to 2018, and no new issuers or investors could be attracted. On a positive note, STS has gained broad acceptance as new market standard in the asset classes residential mortgages (RMBS), auto, consumer and equipment leasing ABS.

This has been supported by the independent third-party verifications of the STS criteria. The strong regulation, acceptance of STS and increased transparency have strengthened confidence of politicians, central banks and supervisory authorities. However, this positive aspect only applies to the Term ABS market.

The picture is different for private securitisations and ABCP, as well as the market for capital relief trades, together making up a volume of ca. €200-250bn p.a. in Europe. The new Securitisation Regulation does not reflect the particularities of these market segments, with sometimes inconsistent, inappropriate and prohibitive rules and reporting obligations. ABCP securitisations should be treated as what they are: Highly secured funding instruments, allowing banks to finance the real economy and receive secured refinancing with short maturities, similar to covered bonds at the longer end of the maturity spectrum.

Securitisation will contribute to stability and be part of the solution this time.

Still a series of changes and improvements need to be made to the level 1 regulation and certain level 2 RTS issued by the respective ESAs. The level playing field of securitisation with other products like covered bonds as part of the Capital Markets Union still needs to be achieved. A clear and consistent ruleset for banks applying significant risk transfer (SRT) for capital relief needs to be established by the legislator and applied uniformly from supervisors across Europe.

Especially in the context of the current situation with severe consequences due to Covid-19 for the real economy and the stability of the financial system, this once again shows the necessity for clear and consistent rules, limited complexity and no procyclical consequences. Under these premises and based on trust, securitisation will contribute to stability and be part of the solution this time. ●

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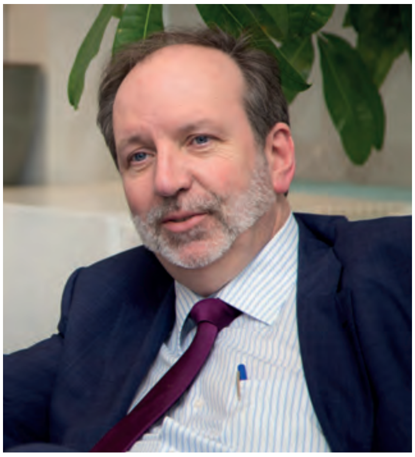
CCPs outstanding issues



John Berrigan

Director-General, DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

Making clearing safer: two new frameworks for CCPs

In mid-October 2019, the European co-legislators adopted a set of targeted amendments to EMIR – the European framework for CCPs – to strengthen the supervision of CCPs in light of their growing systemic importance ('EMIR 2.2'). The objective is twofold: first, fostering convergence in the supervision of CCPs established in the EU, and, second, improving the supervision of third-country CCPs that provide services to EU firms according to the risk they present for the stability of the EU financial system. While not being the only driver, these amendments are of course especially important for the EU in the Brexit context.

The new rules enhance the supervisory role of ESMA and EU Central Banks over third-country CCPs. The amendments introduce a new category of third-country CCPs that are systemic for the financial stability of the EU, and that could therefore become subject to specific requirements and direct supervision from ESMA. As a last resort, the Commission can also require a third-country CCP to provide certain services to EU firms from within the Union. The Commission will soon come up with a set of delegated regulations that will specify how EMIR 2.2 shall be implemented. The Commission is working to make the new approach proportionate, predictable and efficient, while safeguarding financial stability.

The implementation of EMIR 2.2 will require close cooperation with our international counterparts with which we intend to keep an open and balanced dialogue in order to reach a proportionate and common approach to deference in the field of CCP supervision.

Already in 2016, the European Commission adopted a legislative proposal for a framework for the recovery and resolution of CCPs. While a CCP failure is an unlikely event, it is essential to have in place rules that will enable us to deal with such a situation should it occur. The Commission proposal implements the internationally agreed FSB framework, ensuring that the critical functions of CCPs are preserved while maintaining financial stability and protecting the taxpayers.

The European Parliament adopted its report in March 2018 while the Council adopted its general approach in December 2019. The positions are close, hence a political agreement could be reached soon – potentially during the Croatian presidency.

The current points of divergence are twofold. First, both the Council and the Parliament have proposed to increase the involvement of the CCP's own resources in the recovery phase. The Council does not require this additional involvement to be prefunded, to the contrary, the Parliament proposes to significantly increase this involvement and make it prefunded. Second, on decision-making in resolution, while insisting on a fair representation of all relevant authorities of potentially affected Member States, the co-legislators recognise the primary role of the CCP's resolution authority but have different views on the design of the resolution college and on when and how to inform the resolution college about resolution actions.

The CCP Recovery and Resolution Regulation will complete the legal framework applicable to CCPs in order to ensure safe clearing in the EU. ●

Robert Ophèle

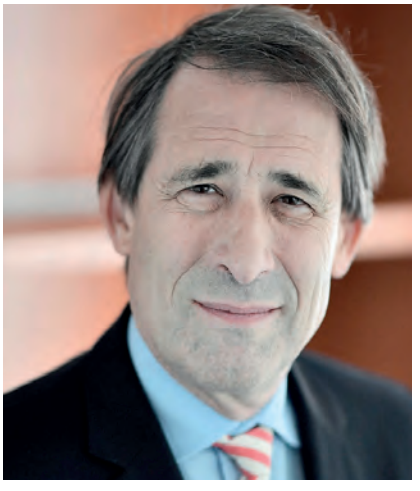
Chairman, Autorité des Marchés Financiers (AMF)

EMIR 2.2, a new allocation of supervisory responsibilities for CCPs

On 2 January 2020 EMIR 2.2 entered into force, revisiting supervisory arrangements for EU and third-country CCPs in light of the growing size and cross-border dimension of clearing in the Union.

EMIR 2.2 clearly allocates the supervisory responsibilities and enhances ESMA's role for both authorised EU CCPs and recognised third-country CCPs, especially through the creation of the "CCP Supervisory Committee", an internal committee of ESMA composed of a Chair, two independent members and the competent authorities of Member States with an authorised CCP.

Regarding EU CCPs, diverging supervisory practices across the EU have brought out the need for supervisory convergence: in particular, there have been discrepancies in national practices with respect to the consultation of supervisory colleges ▶



- for the purpose of issuing an opinion on CCP extensions of activities and services (Article 15 of EMIR) or risk model changes (Article 49).

Under EMIR 2.2, the home-country supervisor remains ultimately the responsible competent authority of the CCP but ESMA's role has been reinforced in order to promote a convergent approach towards European CCPs and to homogenise the application of EMIR across the EU.

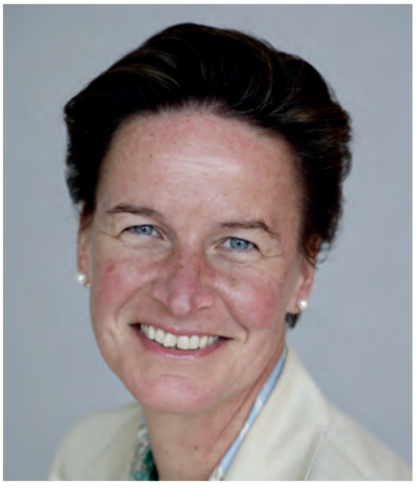
The new CCP Supervisory Committee is responsible for conducting analyses, such as peer reviews of the supervisory activities towards CCPs or Union-wide stress tests of the resilience of CCPs, and promoting convergence between competent authorities and across Colleges through decisions and opinions, especially with regard to supervisory areas which have a cross-border dimension or impact, such as access of trading venues to CCPs (and vice versa), interoperability arrangements, authorisation and extension of services and activities. [The recruitment process of the Chair and the independent members of the CCP Supervisory Committee is in progress and ESMA's Board of Supervisors should appoint them in the coming months].

> *ESMA's role has been reinforced in order to promote a convergent approach towards European CCPs.*

In addition, the composition of EMIR Colleges has been enlarged to central banks of issue and additional competent authorities, where the jurisdiction's financial stability could be impacted by a CCP's financial distress, and their role has been strengthened. EMIR Colleges can provide opinions on additional supervisory areas and a comply or explain process has been introduced for the competent authorities when they significantly deviate from an opinion issued by the College.

Regarding third-country CCPs, ESMA is responsible, mainly through the CCP Supervisory Committee, for classifying third-country CCPs depending on the level of systemic risk they pose for the Union and effectively and directly supervising recognised CCPs that are determined to be systemically important Tier 2 CCPs. ESMA powers include the ability to conduct investigations and on-site inspections and to impose fines. Besides ESMA, relevant Union central banks of issue are also involved in the recognition, supervision, review of recognition and withdrawal of recognition of third-country CCPs.

The implementation of this new regime is pending, subject to the finalisation of the Delegated Acts that will define the tiering criteria and the conditions for comparable compliance. This is particularly sensitive taking into account the perspective of the end of the Brexit transition period. ●



Verena Ross

Executive Director, European Securities and Markets Authority (ESMA)

Putting in place ESMA's new supervisory powers

EMIR 2.2 came into force on 1 January 2020. One of the first measures adopted by ESMA has been to establish the CCP Supervisory Committee as an internal committee of ESMA, creating the new governance and decision-making process. While the recruitment of the Committee's Chair and the two Independent Members is ongoing, the committee has met already a number of times in its interim composition and is organising its new tasks with respect to EU-CCPs.

The provisions in EMIR 2.2 introducing new tasks and processes promoting supervisory convergence in the supervision of EU-CCPs are already applied by ESMA, the relevant competent authorities and CCP colleges. For example, in the case of significant changes to risk models and parameters, CCPs are already applying the revised process.

ESMA has also established a CCP Policy Committee to deal with the new regulatory mandates in EMIR for developing draft regulatory technical standards (RTS) and guidelines. ESMA is now finalising its draft proposals to adjust existing RTS and guidelines on CCP colleges to the new tasks and processes envisaged in EMIR 2.2, and will next work on the remaining mandates for RTS specifying when an extension of authorisation is required and a change to a CCP's risk model or parameters is significant and subject to validation.

However, the provisions in EMIR 2.2 introducing a new regime for the recognition and supervision of Third Country CCPs (TC-CCPs) are not yet applicable, pending the adoption of the relevant Delegated Acts by the European Commission.

In November 2019, ESMA provided the European Commission with technical advice concerning these Delegated Acts in relation to (i) the tiering criteria to be taken into account by ESMA when determining the systemic importance of TC-CCPs (ii) the minimum elements and the modalities and conditions when assessing comparable compliance for systemically important TC-CCPs, and (iii) the supervisory fees for TC-CCPs.

ESMA's role and ability to perform effective supervision of TC-CCPs will be largely determined by these Delegated Acts. They will determine the TC-CCPs that will be in scope of ESMA's more robust supervision, due to the fact that these CCPs are systematically important for the European Union or one or more of its Member State(s). They will also determine the nature and extent of ESMA's assessment of compliance of those so-called "Tier 2 CCPs" with the EMIR requirements under the new comparable compliance regime and they will determine the fees charged to finance ESMA's supervisory activity. Fees are key to ensure that ESMA's required supervisory costs related to TC-CCPs are covered by the entities and not by EU taxpayers. ●

Toks Oyebode

Executive Director, Regulatory Affairs,
J.P. Morgan

Better aligning incentives between CCPs and market participants

It is generally understood that CCPs have grown in systemic importance since the 2008 financial crisis. Together, regulators, CCPs, and market participants have made strides towards improving CCP resilience, recovery and resolution planning. However, a number of critical issues remain outstanding. Moreover, the current period of market volatility associated with COVID-19 is likely to highlight strengths and vulnerabilities in the system.

J.P. Morgan recently published a paper alongside eighteen other global buy- and sell-side institutions – "A Path Forward for CCP Resilience, Recovery, and Resolution" – which identifies outstanding issues that regulators and CCPs should consider and makes twenty recommendations to address them.

In the spirit of ensuring on-going financial stability in times of market disruption or crisis, the paper seeks to better align incentives between CCPs and market participants and ensure that clearing member and end-user liabilities are appropriately limited and manageable. In doing so, the paper seeks to protect financial stability and ultimately taxpayers, by ensuring that CCPs are resilient and that recovery and resolution processes are reliable and are not procyclical. The paper is intended for a global audience, but many of the recommendations are directly applicable to matters under consideration in the draft EU Regulation on CCP recovery and resolution.

- On resilience, the paper recommends that CCPs should make material contributions of their own capital to the default waterfall in two separate tranches, as a mechanism to align a CCP's incentives and ensure effective risk management related to the CCP's clearing activities. In addition, it recommends that CCPs should be responsible for non-default losses, supported by appropriately sized regulatory capital requirements.
- On recovery, the paper emphasizes the importance of compensating market participants for losses incurred through the use of recovery or resolution tools and capping pre-defined assessment rights at an amount equal to each clearing member's default fund contribution. In addition, the paper emphasizes the need for appropriate governance and regulatory oversight of the use of procyclical recovery tools.
- On resolution, the paper recommends that CCPs set aside ex-ante resources (e.g., issuance of long-term debt that could be bailed-in) for recapitalization, and that regulators conduct regular reviews of CCP rulebooks to ensure a common understanding of CCP risk.

These and other recommendations are covered in more detail in the full paper.
The EU should be commended for introducing important measures to improve the safety and soundness of derivatives markets and related financial market infrastructure through the European Market Infrastructure Regulation (EMIR) in 2013. The draft EU Regulation on CCP recovery and resolution presents an opportunity for further progress through the establishment of a comprehensive framework to address the recovery and resolution of CCPs.

While the existing draft Regulation is an important step forward, we strongly believe more can and should be done. Incorporating the recommendations of this industry white paper into the Regulation would further the goal of enhancing financial stability through even more resilient and robust CCPs within the EU. ●

Daniel Maguire

Group Director, Post Trade Division,
LSEG & Chief Executive Officer, LCH Group

CCP R&R – Why access to highly liquid markets and resilience matters

The EU CCP Recovery and Resolution (R&R) framework seeks to ensure that, if the conditions for a CCP R&R are met, swift action can be taken to: (i) safeguard financial stability; (ii) secure the continuity of the CCP critical functions; and (iii) protect taxpayers. We are fully supportive of these objectives and believe that resolution (and to a further extent, recovery) should be managed by the clearing community (including CCPs, clearing members, clients, competent authorities) without recourse to taxpayers.

CCPs manage the risks of the wider market and act as circuit breakers in case of crisis. The use of R&R tools would therefore be the result of a much wider stressed market scenario whereby, for example, several major banks would have defaulted on their obligations towards the CCP, and their corresponding capital requirements and resolution regimes have proven to be insufficient. Even under these conditions, margin requirements and mutualised ▶

resources should still allow CCPs to manage extreme but plausible scenarios. It is therefore imperative to focus on the prevention of a crisis, by ensuring that CCPs operate to the highest standards. It is also vital that everyone is incentivised to support these strong resilience standards.

However, CCP R&R discussions have not typically focussed on prevention, and instead focused on increasing CCP resources to cover for losses from a default. It is important to recognise that increasing CCP resources to cover default losses in recovery or resolution does not strengthen financial stability or CCP resilience. In fact, this would have the opposite effect and increase CCP 'dead capital', which would limit the resources available to strengthen their resilience and increase clearing costs. This could also run counter to and hence change clearing members' incentives to support the liquidation of a defaulter's portfolio, potentially weakening the resilience of the whole system.

We believe that, in order to ensure a safer and more robust clearing community, in line with CCP R&R objectives, the discussion should be focussed instead on the following two aspects:

- **How to ensure a resilient and diversified CCP membership,** in particular by ensuring that only strong profiles have access to the CCP. CCP membership should also be sufficiently diversified (to limit wrong-way-risk) and actively engage in CCPs' fire-drills, to ensure it is well prepared to respond to a market event.
- **How to ensure the corresponding diversified supervisory input:** CCP R&R is unlikely to happen in isolation: there is a need to ensure a wide and diversified regulatory overview and input into CCP supervision, and also to 'stress-test' supervisory cooperation to ensure that the entire clearing community (including authorities) is well prepared.

CCP R&R frameworks should be implemented in such a way that there is sufficient preparedness primarily within the clearing community to manage shocks in the most effective way. Supervisors must also be able to use the relevant tools to ensure close ex-ante coordination. In addition to the increased scrutiny on CCP resilience, bringing the clearing community closer is the 'extra-layer' that will be most beneficial to financial stability, and ultimately, taxpayers. ●

Jochen Metzger

Director General,
Payments and Settlement Systems,
Deutsche Bundesbank

It's all about incentives!

The EU CCP R&R proposal is the latest addition to regulation following the financial crisis. It provides a framework for dealing with events even beyond extreme but plausible scenarios. Since the introduction of the clearing obligation for OTC derivatives, CCPs have become even more crucial providers of post-trade services. Hence, rules on how to deal with default and non-default related losses are imperative. One particular challenge is how to deal with losses which exceed the resources provided for by the rulebook. In the CCP R&R this challenge is addressed by a multitude of instruments, one of which is a cash call reserved for the use of the resolution authority to cover losses from default as well as non-default related events.

In general, resolution is a very severe and disruptive situation that should be avoided. The best resolution is the one that does not take place. We need to test and increase the resilience of CCPs, applying scenarios in which established correlations cease to exist.

The default management process of a CCP determines the size of the losses. This means that management, shareholders and participants need compelling incentives for contributing to its success. Auctions play a pivotal role here. The more successful the auctions, the more likely it is that the CCP will recover without recourse to recovery measures or resolution.

A strong incentive for the CCP to ensure effective risk management and soundly designed auction processes is its own contribution to the default waterfall, which in the EU currently stands at an additional 25% of a CCP's capital. The draft R&R regulation seeks to add another 25% when in recovery. For clearing members, unsuccessful auctions can mean that losses are mutualised as agreed in the rulebook, pre-funded resources may be used up and need to be replenished through the assessment regime. Or worse, if losses persist, positions may be returned to the clearing member via partial tear-up. Such consequences represent a clear and strong incentive for clearing members to make meaningful contributions in auctions and should not be weakened by additional contributions of the CCP.

Non-default losses can originate from investment risks, custodian and settlement risks, operational risk, and legal risk and are supposed to be covered by the capital of a CCP. One exception are investment losses where loss-sharing arrangements with clearing members often exist. The draft EU regulation also provides for a cash call in case of resolution caused by a non-default related event. The welcome advantage of this is that it gives the resolution authority additional resources to cover losses. However, it may have repercussions on the incentive structure as clearing members will have to cover losses for which the CCP's shareholders and management bear the ultimate responsibility.

EMIR requires that capital be calibrated by the CCP with the approval of its regulator such as to also cover risks from non-default losses, and the FSB is working on guidance to help resolution authorities calculate potential gaps in resources for loss coverage with the aim of closing them. In the case of non-default related losses, more CCP-side contributions could help avoid increasing the burden on clearing members. ●

Capital market development in CEE

Pierre Heilbronn

Vice President, Policy and Partnerships, European Bank for Reconstruction and Development (EBRD)

CEE capital markets in the post-crisis environment

The earlier global financial crisis of 2007 hit the economies of Central and Eastern Europe (CEE) hard, exacerbated by over-reliance on foreign currency lending, a highly Eurorised economy and low levels of domestic savings. The actions agreed at the Vienna Initiative stemmed the immediate financial stability risks and established that a move away from an over-reliance on traditional banking services was an absolute priority.

A lot of constructive policy reform has occurred since then- including the launch of the EBRD's "Local Currency and Capital Markets Development Initiative" in Zagreb in May 2010- but the latest crisis, precipitated by the COVID-19 pandemic, and the capital outflows from the region, show that there is some way to go.

We recognise the CEE as a dynamic region, which has the potential to grow at a faster rate than the EU as a whole. Integrated capital markets must remain an essential part of this formula, and a constructive and innovative approach is required to shift these economies in the right direction.

The CEE countries face specific challenges in developing their financial sectors due to the limited size of their individual markets. Any policy interventions, including post-crisis response, should consider these when arriving at solutions:

- Recent events suggest that an on-going priority is to develop secondary market liquidity in order to build investor confidence – volatility in markets was exacerbated by the inability to execute trades and hedge currency and interest rate risks. Facilitating access to local markets for all investors is key, as well as developing connectivity, and reducing transaction costs.
- Linked to this, single country solutions for developing capital market infrastructure tend to be uneconomic and do not pique investor interest. Regional solutions that highlight the CEE as a "region within a region" are preferred.
- Local capital markets in CEE countries do not attract investors nor support larger issuers because of their limited scale. Under-developed money markets, domestic government and corporate bond markets undermine strong, market-oriented economic development.
- Banks still finance 90% of the economy in CEE (the EU average is 75%) and focus on traditional business, resulting in a relatively limited range of financial products available. The rise of innovative products, such as covered bonds, is recent and limited.
- EU funds have been valuable in targeting public sector and infrastructure development, but there are huge gaps in access to finance for the private sector, particularly SMEs. SMEs will also be hardest hit by the adverse effects of the current crisis.

The EU Capital Markets Union is a hugely beneficial initiative, which will remain integral in post-crisis actions to reopen financing channels. It needs to remain an agile framework that takes into account the distinctive challenges of the CEE countries.

So, where do we go from here? Regardless of whether we are undertaking crisis response or post-crisis rebuilding, 'regional initiatives', something that the EBRD has championed for many years, must remain a priority. Short-term Central Bank securities purchase programs and IFI support facilities to boost liquidity are valuable but we also need to address the core issues of instrument supply, secondary market liquidity and regulation on an on-going and multi-asset basis.

> *Going alone is not an option: through collaboration, CEE countries can tackle the unique challenges they face.*

In the Baltic States, expansion of products through uniform Covered Bond and Real Estate Investment Trust (REIT) regimes, championing a regional index, and promoting their green credentials, are tangible steps in supporting our broader effort to obtain a single Frontier market classification for these combined markets.

Equally, the SEE link project currently connecting the stock exchanges of seven countries in a virtual trading hub – should boost secondary market liquidity when the clearing and settlement infrastructure is connected in Stage II. Harmonisation of regulation both facilitates investments and enhances private sector competitiveness.

Capital markets in the CEE region will only flourish if we continue promoting collaborative innovative solutions and strategic priorities.

Going alone is not an option: through collaboration, CEE countries can tackle the unique challenges they face. Should they grab it, they will show that unity makes strength. ●

Tomislav Ridzak

Member of the Board,
Croatian Financial Services Supervisory Agency (HANFA-CFSSA)

Capital markets promote best practices for corporate governance in the CEE

Capital market development is important for any country and its effects go beyond financing. Specifically, in the CEE region capital markets are important promotor of best practices for corporate governance. Companies that are listed on the market adhere to higher standards of corporate governance and serve as a role model for other companies. If the listing is successful and other companies follow suit, positive economic and social effects of good governance spread throughout the economy.

However, the importance of promoting and adhering to higher standards of corporate governance does not mean that financing part of the equation is not important. Especially in times of crisis, one can clearly see that the companies with strong balance sheet, that are adequately capitalized, fare better. Such companies have less need to shrink their business, and weather the storm much better than companies that use a high leverage based on debt. As a result, social costs of adjustment for those companies are much smaller. Croatian experience from previous financial crisis that started in 2008 had shown exactly that. Croatian companies that were highly leveraged experienced significant problems and had to adapt to new reality where financing was scarce with significant costs. This change also affected lenders, with non-performing loan ratio for medium sized enterprises surpassing 30 per cent and for the large corporations 19 per cent. On the other hand, companies that were solidly capitalised fared much better through recession.

Although the CEE region is not big, there are significant differences in terms of capital market development and levels of cross border investments. Several decades after their (re)opening, there is relatively big variation between regional stock markets in terms of trading volume and listed shares. Originally, at the beginning of transition, stock exchanges and public listings were a venue where recently privatized state owned companies listed their shares in order to facilitate trading for new owners. Nowadays, we see relatively livelier trading on some of the exchanges (i.e. Warsaw stock exchange, Bucharest stock exchange). On the other hand, many other CEE exchanges have firms with significant market capitalization listed while trading is less dynamic. Some exchanges seem to settle in an equilibrium with low turnover and only few listed companies. Finally, international integration of the regional stock exchanges also varies, where exchanges with more turnover attract more international investments.

Capital markets union is an important part of the single market that should be further promoted in the future. At the same time, regional markets are still very important in the CEE countries. Plans to further develop capital markets union should take this in to account. Many companies that are listed on regional exchanges will not list on the big EU exchanges due to various reasons (i.e. listing requirements, costs, dual reporting, etc.). On the other hand, some companies that surpass the ability of the local market to service them, will graduate towards dual listings on bigger EU exchanges. However, in order to save the ability of such companies to fund on capital market and preserve ecosystem of financial intermediaries, we must implement sensible policies. Decreasing regulatory requirements for financial intermediaries that operate on a small scale while increasing capital market integration should provide relief and incite the development of regional capital markets not only in CEE but throughout European Union. By doing so, we are increasing options for consumers with supply of more readily available products from intermediaries throughout EU, while at the same time giving chance to regional markets and intermediaries to operate with the regulation level that is suitable to their size and risk profile. ●

Leonardo Badea

Deputy Governor, National Bank of Romania

Continuing the development of capital markets in Romania

Unquestionably, modern capital markets have come a long way in Romania since their reopening during 1990s, their evolution being in close sync with the development of the market economy and the consolidation of the democratic society after the communist era. However, as it is often the case almost in all areas, this progress has not been linear and has not always been consistent. In financial markets, our most valuable asset is trust, that's why all the past major crises took their toll and caused important setbacks, as will certainly be the case with the one that we are fighting now.

Today, Romanian capital markets are mostly aligned with developed western European capital markets in terms of institutions, systems, technical capabilities and interconnections, regulation and best practices, thus are better ▶

equipped to go through bad times and to recover afterwards, although it will most probably not be an easy or fast recovery given the complexity of the crisis.

> *Romanian capital markets are now better equipped to withstand bad times and to recover afterwards.*

Of the two main sectors of the capital markets, the collective investment undertakings enjoyed a significant increase in assets during the last years, especially for the open-end fixed income funds, while the alternative investment funds remains an important segment (mainly former privatization funds - a particularity of the Romanian market). The structure of funds by risk categories is well diversified and the situation should further improve once the new law regarding the alternative investment funds is implemented.

The other main sector, the stock market, experienced a significant decline during the global financial crisis (both as a traded value and as a level of the stock indices) and was not able to recover in a consistent manner since than. Moreover, the term market for derivative financial contracts has gradually decreased until total termination of transactions in 2017. Although there are projects to restart it, they are largely dependent on the success of the current actions for the establishment of a local central counterparty. As a result, the market is currently mostly focused on stock transactions, and traded values are only slowly improving, being still below 2007-2008 levels, despite listings of major companies over the past two years.

Also, the market capitalization related to GDP is rather low when comparing at regional level. In order to recover the gap compared to the European average, we need to continue the efforts for listing new companies, to stimulate the local corporate bond issuances and to restart the financial derivatives market.

Perhaps the most important recent progress was registered in September last year when the FTSE - Russell rating agency published the decision to promote the Bucharest Stock Exchange to the emerging secondary market status. Also, significant steps were made towards the setting up the local central counterparty and for resolving the situation of latent accounts of financial instruments (with the Central Depository), with the support of the EBRD. An optimal and rapid conclusion of these projects will certainly have benefits for the entire local financial markets. We are also currently working at a national strategy for developing the capital markets, with the help of World Bank, following similar examples in our region. ●

Lukasz Januszewski

Member of the Board,
Raiffeisen Bank International AG

Capital markets development requires long-term players

What are the main areas of improvement and future development objectives of capital markets in the CEE region?

When it comes to local bond markets, we have seen a shift to local currency issuance by the major sovereigns in the CEE region in recent years. Such a move boosts the depth of local capital markets and strengthens sovereign credit profiles. Moreover, we have seen increasingly long maturity local currency debt issuance, lengthening the duration of government's liabilities.

All in all, the above-mentioned trends contribute to the development of a dedicated local and international investor base, a key aspect for developing capital markets and an important business area for leading banks in the region such as RBI.

How are banks such as Raiffeisen contributing to the development of capital markets in the CEE region and are there significant challenges or obstacles?

Capital markets development requires long-term players, such as RBI, who understand the region's economies and spreads best-in-class know-how across markets.

> *Capital markets development requires long-term players, such as RBI, who understand the region's economies and spreads best-in-class know-how across markets.*

RBI continues to grow as a primary market dealer and now provides direct LCY government bond auction access in 11 government bond markets in the region. Alongside this RBI continues to invest heavily in trading technology to facilitate secondary market making in interest rates, equities and FX.

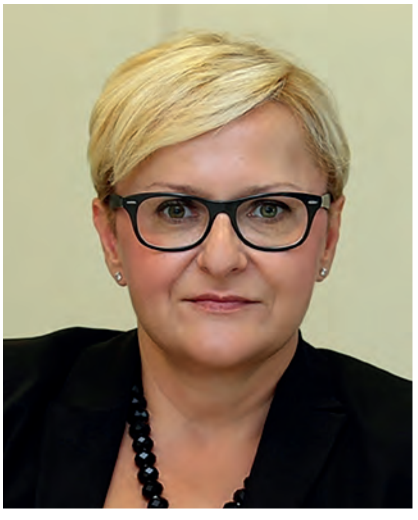
The group also supports corporates and governments in the region hedge risk through a broad cross currency and interest rate derivatives offering. RBI also continues to leverage its capital markets franchise to arrange bond financing for the region's sovereigns and corporates and within this is increasingly active in green bonds too. It goes without saying that RBI is actively working on bringing Western investors in the CEE region.

Do current EU and regional policies support appropriately the development of capital markets in the region?

▶ The EU's Capital Markets Union project is also positive for CEE capital markets development, especially given the CMU also covers ECM, corporate bond issuance and venture capital. For CEE, this means that larger corporates may get easier access to international/offshore financing. In terms of green financing and the European Green Deal (EGD) we also see a lot of potential. However, estimated investment sums for "greening" in CEE far exceed public funds announced to date. In this respect, considerable private sector co-financing will be necessary. Therefore, the EGD could contribute to the development of local capital markets in the area of long-term and structured financing in CEE. Participation in such a process would certainly be of interest to players like RBI.

What new or additional actions may be needed?

Three areas are important: (a) a clear classification system for sustainable economic activities for green finance. (b) faster progress in CMU. (c) an inclusive framework for non-euro area EU capital markets. The fact that the euro area is largely limited to Western EU members suggests that the ECB monetary policymaking shall not be instrumentalised for the EGD implementation. Such a move would possibly fuel further scepticism among EU members in CEE towards the EGD. It goes without saying that having strong private pensions systems would support local Capital Markets development and ensure a steady stream of new equity and debt finance for domestic economies. ●



Ivana Gažić

President of the Management Board, Zagreb Stock Exchange

Croatia: leading the capital markets development in the region for 30 years

Croatian capital market has been leading the development of the capital markets in the region for almost 30 years and represents a bridge between the European Union and the rest of the region.

Croatia joined the EU in 2013, and it can be said that long before that, the financial sector was completely ready for this step and harmonized with the EU regulation. And for a long time before that, we followed all EU and global trends and working on developing the capital market in line with the best European and global practices. From this standpoint, it proved to be quite beneficial for Croatian capital market, and many Zagreb Stock Exchange's (ZSE) project were supported by the EBRD.

ZSE's strategy is to ensure the highest level of transparency and open up some new investment opportunities as well as create the conditions to provide growth capital to companies in all stages of their development, fostering a positive environment for entrepreneurs that also will be conducive to economic growth and employment.

In order to achieve these goals, ZSE has developed several solutions as a part of its integrative strategy. Young innovative companies will be the main driver in the years to come, and therefore it is extremely important to keep them operating in an environment in which they were established and enable them to access the capital for growth and development. ZSE has a 20% interest in the Funderbeam South-East Europe Company, a part of the Estonian Funderbeam Group, which operates a start-up financing facility and runs an innovative trading platform for start-ups based on blockchain technology. To date, Funderbeam SEE has enabled Croatian start-ups and SMEs to raise more than EUR 5 million in capital via 10 campaigns.

Progress Market was registered as one of the first and very few SME growth markets in Europe. It is a multilateral trading facility which may be used by small and medium-sized enterprises as a vehicle for the implementation of their investment plans.

Cooperation between markets is a necessity. As owners of the Ljubljana Stock Exchange, ZSE sees many positive effects for both exchanges and both capital markets. At the very close of the year 2019, the ZSE acquired a 5.3% share in the Macedonian Stock Exchange (MSE) as a step towards active participation in its development.

Together with Bulgarian and Macedonian stock exchanges, the SEE LINK Company was established in 2104 with the objective of creating a regional infrastructure for trading securities listed on those three markets. SEE Link order-routing system now supports trading for a total of seven markets, with over 1500 securities eligible for trading. A total of 26 investment companies are licensed to trade via SEE Link. There are still many challenges ahead of obtaining full potentials of this project, primarily regarding the solution for settling cross-border trades.

> *Leading the development of the capital markets in the region for almost 30 years.*

ZSE's goal is to continue to lead the development of the capital market in the region while providing transparent, secure, cost-effective and efficient marketplace as well as obtaining the highest quality of capital market services in order to meet the needs of investors, issuers and all stakeholders. ●

Photo by Karel Šanda

Miroslav Singer

CEE Institutional Affairs & Chief Economist, EXCO Member, Generali CEE Holding B.V.

Insurance as the driver of the development of Balkan Capital Markets

The potential contribution of the Insurance industry to the development of Balkan and the „new Europe" states capital markets cannot be overstated. This is clear from comparisons with the developed European economies. The investment portfolios exceed 60% of GDP of an average European economy, such as Belgium or Germany. In some cases, Spain, Sweden, UK not to focus on somehow specific Luxembourg case, they are comparable with the GDP. Thus, investment portfolios of insurance companies -in line with one of the major social benefit of insurance companies, i.e. investments into the valuable but lower liquidity long-term projects-, support the development of capital markets and the economy as a whole. The situation contrasts sharply with the Balkans and „new Europe." Here investment portfolios of insurance companies are much smaller. They range between few percent of GDP – Bulgaria, Romania – and a quite meagre 15% (circa) of GDP in the case of Slovenia. The unfulfilled potential is clearly enormous.

As for the state of financial markets in the region let me stress that since the Generali group insurance companies are present in most CEE and Balkan countries, we can dare to assess the situation with a local perspective. Currently, only the „big new 4" countries – Czech Republic, Hungary, Poland and Romania –possess reasonable liquid forex and governmental bond markets. Once we begin to asses less elementary instruments, we find only three CEE economies that can enjoy sufficiently liquid IRS markets. And moving further up the ladder of sophistication of products, the situation gets worse. Smaller Balkan economies do not have a depth of markets thanks to both lack of issuers and investors for domestic currency debt, in terms of euros the situation is a bit better but keep in mind international buyers are open to consider issues over 300 million euros from rated issuers... As to equity markets, their development is related to pension or health reforms. The largest equity market in Poland reflects the size of the Polish pension industry and also the regulation limiting hedging of the portfolios. The relatively larger assets of the insurance industry in Slovenia is a consequence of a health system mainly based on private insurance.

As to the role of global players like Generali, I believe that apart from an obvious role of investor, we are contributing to the development of the market by setting the example to other market players as well as setting standards that in some markets are stricter than those set and enforced by local authorities. We are observing in compliance with group ESG standards preventing us from investments of some issuers, we are flag bearers of implementation of new pan-EU regulation in countries and being an anchor investor, we are simply with our presence making some issues reality.

Of course, EU regulation plays a positive role as local authorities strive for convergence. At the same time its implementation is rather expensive, and the costs associated might hinder the arrival of new investors in many smaller Balkan markets. Consequently, a simplification corresponding with the market size might become a significant impulse for the development of those. ●