

MEMO# 28743

February 18, 2015

European Commission Green Paper - "Building a Capital Markets Union"

[28743]

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TO: ICI GLOBAL CAPITAL MARKETS UNION TASK FORCE
ICI GLOBAL STEERING COMMITTEE No. 1-15
ICI GLOBAL REGULATED FUNDS COMMITTEE No. 5-15
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 6-15
FIXED-INCOME ADVISORY COMMITTEE No. 4-15
EQUITY MARKETS ADVISORY COMMITTEE No. 1-15
INTERNATIONAL COMMITTEE No. 9-15
INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 2-15 RE: EUROPEAN COMMISSION
GREEN PAPER - "BUILDING A CAPITAL MARKETS UNION"

The European Commission ("the Commission") published a Green Paper on "Building a Capital Markets Union" on 18 February. [\[1\]](#) The Green Paper sets out the key principles, priorities, challenges, opportunities and next steps for a Capital Markets Union (CMU). Interested parties are invited to submit their answers to the questions in the Green Paper by 13 May 2015. ICI Global intends to respond. The publication of the Green Paper was accompanied by two related consultations – one on the review of the Prospectus Directive and another on the creation of an EU framework on simple, transparent and standardised securitisation.

Background to the CMU

In November 2014 Jean Claude Juncker announced the CMU during his candidacy for President of the European Commission. [\[2\]](#) Juncker stated that the objective for the CMU to "further develop and integrate capital markets". In doing so he asserted that this would "cut the cost of raising capital, notably for SMEs", "help reduce (the EU's) very high dependence on bank funding" and "increase the attractiveness of Europe as a place to invest".

Responsibility for the CMU was subsequently allocated to Lord Hill, Commissioner for Financial Stability, Financial Services and Capital Markets Union. The Commission then announced its intention to publish a Green Paper [\[3\]](#) and an action plan to build the CMU. [\[4\]](#)

Overview of the Green Paper

In the foreword to the Green Paper, the Commission frames the CMU initiative in the context of its jobs and growth agenda. The Commission asserts that no single measure will deliver a CMU, but that a range of measures will be required. The Commission cites the need to make progress on several long-standing issues including insolvency and securities law, and tax treatments, and furthermore commits to take action over the coming months to:

- develop proposals to encourage high quality securitisation and free up bank balance sheets to lend;
- review the Prospectus Directive to make it easier for firms, particularly smaller ones, to raise funding and reach investors cross border;
- start work on improving the availability of credit information on SMEs so that it is easier for investors to invest in them;
- work with the industry to put in place a pan European private placement regime to encourage direct investment into smaller businesses; and
- support the take up of new European long-term investment funds to channel investment in infrastructure and other long term projects.

The Commission commits to “put in place the building blocks of a well regulated and integrated CMU, encompassing all Member States, by 2019”.

The Green Paper is then organised into five sections and includes over 30 questions. Section 1 outlines the rationale for the CMU and sets out several political objectives and principles. Section 2 describes how European Union (EU) capital markets are currently structured, and provides preliminary analysis of some of the barriers to deeper capital markets. Section 3 seeks views on early policy priorities. Section 4 seeks views on the obstacles to cross border capital flows. Section 5 outlines next steps.

Section 1 - Building a Capital Markets Union

In section 1, the Commission generally describes the characteristics of the EU’s capital markets. In particular, the Commission asserts that capital markets are fragmented, organised on national lines and that financial market integration has receded since the financial crisis. The Commission also describes the heavy reliance that European businesses have on banks, the differences in savings and investment patterns, and the competitiveness of European markets at the global level.

The Commission’s five key principles for the CMU are:

- it should maximise the benefits of capital markets for the economy, jobs and growth;
- it should create a single market for capital for all 28 Member States by removing barriers to cross-border investment within the EU and fostering stronger connections with global capital markets;
- it should be built on firm foundations of financial stability, with a single rulebook for financial services which is effectively and consistently enforced;
- it should ensure an effective level of consumer and investor protection; and
- it should help attract investment from all over the world and increase EU competitiveness.

The Commission also outlines three further objectives for the CMU:

- improving access to financing for all businesses across Europe (in particular SMEs)

- and investment projects such as infrastructure;
- increasing and diversifying the sources of funding from investors in the EU and all over the world; and
- making markets work more effectively and efficiently, linking investors to those who need funding at lower cost, both within Members States and cross-border.

Section 2 - Challenges in European Capital Markets today

The Commission describes the role of capital markets in direct financing and channelling funds from savers to investors. It also describes the expansion of capital markets in the EU [5] but notes that public equity markets in the US are about twice the size of those in the EU. The Green Paper also includes other comparative detail on capital markets in other countries.

On challenges, the Commission notes the EU's traditional reliance on bank financing and asserts that this greater dependence on bank lending has made the EU economy more vulnerable when bank lending tightens. The Commission also identifies two challenging features in the EU, namely: that bond issuance is concentrated in larger markets; and that equity markets remain characterised by home bias. In addition, even the best performing national markets in the EU lack critical size, leading to a smaller investor base and fewer financial instruments to choose from.

The Commission sets out the following challenges it would like to address:

- improving access to finance, including risk-capital, notably for SMEs;
- boosting investment flows;
- improving the effectiveness of markets;

Section 3 - Priorities for early action

The following five areas are highlighted as having potential to bring early benefits:

- Lowering the barriers to accessing capital markets – mainly through a review of the Prospectus Directive;
- Widening the investor base for SMEs – through improvements to credit information and the possible development of credit scoring;
- Building sustainable securitisation – through initiatives for high-quality securitisations including a more comprehensive approach in the EU;
- Boosting Long Term Investments – e.g. the European Commission's Investment Plan and European Long-Term Investment Funds (ELTIFs).
- Developing European private placement markets;

The Commission seeks input on the priority areas and the steps that can be taken to support the delivery of the priorities.

Section 4 - Measures to develop and integrate capital markets

The Commission identifies the following three key areas where challenges must be overcome to achieve the benefits of a single market for capital:

- i. Improving access to financing for all businesses across Europe (in particular SMEs) and investment projects such as infrastructure;

The Commission identifies transparency, access to information for credit assessment, and standardisation as possible measures to increase the depth and liquidity of financing markets. Furthermore, the development and enhancement of financing instrument including covered bonds, corporate bonds and green bonds, and crowdfunding.

- ii. increasing and diversifying the sources of funding from investors in the EU and all over the world;

The Commission believes that for capital markets to thrive the markets must attract institutional, retail and international investors. The EU fund management industry, along with the pensions and insurance sectors, are identified as playing a pivotal role in channeling investors' money into the economy. Other possible measures to diversify funding include lower-risk infrastructure debt and/or equity investments, the creation of standardised personal pensions products, and the promotion of risk capital through European Venture Capital Funds and European Social Entrepreneurship Funds.

To boost retail investment, the Commission also seeks to understand how cross-border retail participation in UCITS can be increased. The importance of restoring the trust of investors is cited as a key responsibility and challenge for the financial sector, as is the importance of regulation and supervision in helping to build confidence.

Other measures to increase and diversify the sources of funding include:

- the development of common data and reporting, including post-trade information in a consolidated form and disseminated on a reasonable commercial basis;
- enhancements to market infrastructure and securities law, including a legislative proposal for the recovery and resolution of systemically relevant financial institutions;
- measures to remove barriers to facilitate the flow of collateral throughout the EU;
- legislation relating to investors' rights in securities across different countries as appropriate;
- further reforms to company law, corporate governance, insolvency and taxation.

The Commission also identifies attracting international investment as a key element.

- iii. making markets work more effectively, linking investors to those who need funding more efficient and less costly, both within Member States and cross-border.

To support free movement of capital and support the free movement of capital in the EU and tackle barriers to investment flows in the EU, the Commission cites the development of a single rulebook in recent years as a major step. The Commission however believes issues of "gold-plating" and divergent interpretations have arisen. To that end, the Commission believes that a framework could be developed to govern the treatment of cross-border investment between Member States along with other "improvements" in the short and medium term to the mandate and operation of the ESAs.

The Commission is seeking input as to the further measures that should be adopted, and additional challenges beyond those it has identified in the various areas outlined above.

Section 5 - Next Steps

The Commission intends to host a conference in June 2015 on the CMU and the Green Paper. It will also publish an action plan in summer 2015 with the goal of implementation by 2019.

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endnotes

[1] http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper_en.pdf

[2] http://ec.europa.eu/priorities/docs/pg_en.pdf

[3] Press Release: Commission launches work on establishing a Capital Markets Union, 28 January 2015, available at http://europa.eu/rapid/press-release_IP-15-3800_en.htm

[4] p8, European Commission Work Programme 2015: A New Start, 16 December 2014, available at http://ec.europa.eu/atwork/pdf/cwp_2015_en.pdf

[5] €8.4trn total EU stock market capitalisation in 2013, compared to €1.3trn in 1992 and the total value of outstanding debt securities exceeded €22.3trn in 2013, compared to €4.7trn in 1992

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