POSITION PAPER:

EUROPEAN CAPITAL MARKETS UNION (CMU)

1 October 2020

As recognised by the Expert High-Level Forum report on the European CMU, and in the recently published Commission CMU Action Plan, Europe has 27 national markets for the provision of financial services. Significant progress has been made to bring these together since the CMU Action Plan of 2015, but new challenges relating to the green and digital transformation of the European economy now also shape this agenda. Critically, given the impact of COVID-19, there is now a pressing need to finally deliver on the ambition of a deep and fully integrated European CMU.

In the current circumstances, it will likely become more difficult for banks to generate new capital for lending and provide the European economy with the variety and depth of financial instruments needed for a rapid post-pandemic recovery with many businesses already too reliant on bank lending and debt as a source of capital. Europe needs to find new ways to ensure businesses can access diverse and cost-effective sources of capital, address inherent biases that encourage higher levels of debt, and improve participation by retail investors so high-levels of cash-savings can more be used more productively.

This is not the only challenge currently facing Europe. Pension sustainability in times of rising Government liabilities post-pandemic will require market-based pension systems to supplement state systems. Only with the two working together can those retiring in the coming decades have the benefits they are expecting today. Equally, there are also many different rules and practices for financial markets across Europe, stymying innovation and limiting the ability of investors to finance businesses in different Member States with capital from both within the EU and beyond.

OUR PRINCIPLES

The IA is committed to supporting Europe's long-term economic prosperity, and its transition to a greener, more sustainable future. Our 250 members look after more than €9.5trn in savings and investments – accounting for 37% of the total assets under management across Europe - of which €2.3trn is managed for European clients. Every day, our members help millions of European citizens work towards their long-term financial goals, and by the end of 2019 had allocated more than €718 billion to European businesses of all sizes and descriptions in need of capital.

Creating a deep and fully integrated European CMU is possible, but will require bold and decisive action at all levels, and close cooperation between EU institutions, Member States, and industry to achieve. It is in this spirit we wish to share, based on our members expertise and experience, a set of guiding principles that we believe policymakers should consider when determining the future of the European CMU. Each of these is supported by tangible recommendations that can, and should, be taken to support the continued development of the modern European economy.

The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL
www.theia.org

europe@theia.org

@InvAssoc @The Investment Association

Place the European consumer at the center

European consumers should be empowered to make investment decisions, and enjoy access to a wide range of products, that work best for their circumstances – whilst being appropriately protected wherever they are located. We encourage the adoption of measures which ensure consumers are treated fairly, and are supported by meaningful, transparent disclosures about the risks and opportunities of investing. We believe this will help facilitate a better understanding of investing, boost confidence amongst investors, and increase participation in financial markets - in turn increasing the level of capital available to be allocated.

Promote responsible and sustainable investment practices

The pressing demand for sustainable investment across Europe urges the development of a CMU that is complementary to the EU's wider green agenda. To swiftly scale up investment in line with societal expectations, we support measures which enable investors to better identify, and compare, sustainable investment opportunities, drive the integration of ESG considerations into investment decision-making and risk management processes, and allow our members to exercise their stewardship functions fully in line with the expectations of European savers and investors.

Inspire the use of technology and digital innovation

The delivery of a fully integrated CMU, and levels of engagement within it, will depend on the availability of secure, affordable, and high-quality data, underpinned by increased use of technology in accessing, and monitoring, investments. We urge greater innovation in the types of assets offered to investors, but this must be done in a manner that ensures the security of the system and provides a 'future-proof' framework. We want to help maximise the opportunities for European savers through encouraging technological change, its better application, and more agile methods of supporting businesses in search of capital, and communicating with clients.

Remove barriers to cross-border distribution and investment

One of the principle barriers preventing a truly integrated European CMU is the extent to which products and services can be offered cross-border, not just within the EU but also beyond. Capital should flow to where it can be most useful, in particular in view of the green and digital transition. For this reason, we support the development of a CMU that ensures Europe is an attractive international market and allows investors to pool their capital such as through the Pan-European Pension Product. By remaining open to other international markets, European businesses can benefit from global capital flows, whereas investors can access specialist global expertise and innovative new products.

Encourage open and efficient access to market infrastructure

Market infrastructure plays an important role in advancing opportunities for both investors and businesses, and increasing diversification and risk sharing between market participants. The IA encourages the adoption of measures in the CMU which will help promote deep and liquid capital markets, and provide access to innovative sources of financing for SMEs. For a CMU to function effectively, market participants should be able to benefit from efficient and non-discriminatory access to trading, clearing and settlement facilities, and in a manner which avoids market fragmentation or instability in the wider financial eco-system.

Promote international regulatory and supervisory coherence

Given the globalised nature of financial markets, we believe that authorities should continue to work together to develop effective policies for regulating and supervising markets, supported by structured and regular dialogues. As part of the CMU agenda, we encourage the adoption of measures designed to bring about a more harmonised approach to rule setting in the interest of avoiding regulatory arbitrage between Member States, and the development of more consistent regulatory and supervisory approaches between major financial centers based on agreed international norms.

DELIVERING ON THE AMBITION FOR A CMU

Guided by the principles above, measures adopted through the CMU agenda have the potential to bring a revolutionary shift in how businesses across Europe get the capital they need to become major global players, how citizens can plan for and save for their futures, and open Europe's markets up to international opportunities and capital flows. In this section we provide the industry's perspective on the specific recommendations of the HLF report, the European Parliament's Own-Initiative Report, and Commission Action Plan.

Helping companies and projects raise the capital they need

The creation of a European Single Access Point:

As set out in our Productivity Action Plan, and given the need to recapitalise European's SME's post-pandemic, we welcome efforts to reenergise SME listings on public markets, and capital deployment to public and private equity. As we outlined in our Non-Financial Reporting Directive (NFRD) and Sustainable Finance Renewed Action Plan (SFRAP) consultation responses, a key barrier to increased engagement by investors in SMEs is the lack of consistent, comparable data. Not only do they need usable and easily accessible information to help make informed investment decisions, but so do financial intermediaries such as rating agencies, financial analysts, and research providers.

The IA supports the need for more harmonised disclosures by SMEs and improving the visibility of SMEs to investors and we recognise the need for a more streamlined way for businesses to link to possible investors. We, therefore, welcome the Commission's proposal to establish a centralised database to maintain companies' public financial and non-financial information, as well as other product or activity-relevant public information. The creation of a European Single Access Point would improve the ability for SMEs to access new sources of capital by increasing visibility to investors and provide the consistency and comparability of information needed by investors.

However, a centralised database cannot substitute for continued high-levels of engagement between shareholders and the companies they invest in. Higher governance standards and effective shareholder engagement are seen by overseas investors as representing lower risk, meaning companies can raise capital at a lower cost than competitors in other markets. Maintaining Europe's already high standards and ensuring that companies and shareholders are working together to promote the integrity of the market over the long term, should add value to the European economy, maintaining its position as a competitive market to list and invest.

A targeted review of the European Long-Term Investment Fund Regulation:

Over the past decade, global capital allocated to private markets has doubled from US $2.7trn to more than US $5.8trn, and we expect strong interest from institutional clients into alternative, non-listed assets to continue through 2021/22. By creating a suitable investment vehicle to bring these investments to a sophisticated segment of Europe's retail investor base, a greater take-up of ELTIFs could in turn help catalyse wider interest in late-stage growth finance of unlisted companies and infrastructure funding –areas where there is a demand for investment options across Europe.

As set out in our Future of the UK Fund Regime report in 2019, a targeted review of the European Long-Term Investment Fund (ELTIF) Regulation is necessary and we welcome the Commission's intention to review the ELTIF Regulation. Specifically, these amendments should introduce more flexibility for investors to redeem 'at a mid-point' while reinforcing, where appropriate, liquidity requirements to address a higher risk of client runs. In addition, policymakers should also look at structural features that may encourage participation from a wider range of investors, such as lowering the minimum entry ticket or finding ways to encourage the development of listed ELTIFs.

Simplification of European listing rules and stewardship responsibilities:

There are rightly increasing expectations on investors to discharge their duties as stewards and demonstrate their role in adding value to the European economy. To live up to these expectations they must have the appropriate tools at their disposal by way of rights and responsibilities. However, the listing rules, corporate governance, and stewardship regimes and expectations need to be viewed holistically by Government, Regulators, companies, investment managers, and asset owners to ensure that they are consistently seeking the same aim. This will help to ensure the same behaviours and incentives across the investment chain.

We welcome the Commission's intent to promote and diversify further companies' access to funding by assessing whether the listing rules of public markets (both SME Growth Markets and regulated markets) could be further simplified. To ensure that Europe is home for the world's most innovative companies, it is critical that policymakers consider shareholder rights and stewardship expectations in tandem with any discussion about listing requirements. A fragmented regulatory landscape on stewardship, corporate governance, and listing could result in disconnected expectations of companies and investors and incoherent expectations of companies and investors which could act to undermine the competitiveness of the European market as a place to do business.

Driving greater participation by European consumers

Pension dashboards for Member States and auto-enrolment:

Given the ageing population across Europe, and existing fiscal pressures for Member State Governments that have been exacerbated by the COVID0-19 pandemic, the fiscal sustainability of pension provision will likely remain a major political challenge in the coming decades. Governments will inevitably seek to give individuals more responsibility for making their own pension provision as a result. This creates an opportunity for expanding funded pension systems and deepening national capital markets. It is evident that the Member States with the most developed market-based pension systems also have more fiscally sustainable systems and the most developed capital markets. The UK, for example, in addition to the Netherlands and the Nordic Member States, has a well-developed capital market in part driven by its historical tradition of encouraging funded occupational pension provision. Its decision to introduce auto-enrolment alongside side state-supported pensions in 2012 has further helped the growth of the occupational pensions sector and deepened the pool of capital available for investment in the UK and global markets.

Auto-enrolment in occupational pension plans is the fastest and most effective way to support the development of European capital markets, while providing European citizens with a means to save for their retirement, all while alleviating fiscal burdens on Member States. We agree that the introduction of auto-enrolment should be supported across more EU Member States by developing a blueprint that provides principles for good occupational pension schemes, which Member States could then tailor to their particular pension landscape. Given the industry's experience in supporting the introduction of auto-enrolment in the UK, we welcome the Commission's intention to launch an external study to analyse existing auto-enrolment practices in occupational pension schemes, with a view to developing best practices for such systems in the EU. We would welcome the opportunity to share lessons learned with the Commission to ensure any such systems function as intended.

Pension tracking for individuals and the PEPP:

In addition to clearly communicating the adequacy or otherwise of Member State pension provisions, raising awareness of the need for individuals to make adequate provisions for their future retirement income, for example through individual consolidated annual pension statements and increasing the understanding of appropriate forms of long-term investment, will help encourage individuals to seek suitable solutions and invest in suitable products. However, disclosures used to communicate key information to investors must not be misleading and instead should allow them to better understand and compare key features of any product they are investing in.

We agree with the HLF report regarding the need for a full review of the Level One Text on Packaged Retail Investment and Insurance-based Products (PRIIPs) and an extension of the exemption for UCITS products from the PRIIPs regime until the fundamental flaws in the regime are resolved. It is essential both for customer confidence and the flow of reliable information through the distribution chain that regulators, industry, and other stakeholders work together to ensure that a new generation of digital disclosure frameworks delivers meaningful information. As the front-line point-of-sale document that will be extended to cover retail investment funds directly alongside other retail investment, insurance, and banking products, getting the PRIIP KID right must be a central priority of the EU under the CMU agenda. To protect the interests of retail investors, retail investment funds should continue to be exempt from the requirements of PRIIPs until these issues have been properly addressed.

In addition to ensuring investors have meaningful and transparent disclosures about their investments, this must be supported by the introduction of suitable investment vehicles that match investor requirements. At the heart of ensuring that the pension system and retail investment products more generally are trusted lies the perception that the investment management industry delivers value for money. We do not believe that this, however, automatically equates to lower cost, and caution against the use of fee caps, which invariably have unintended consequences and can make a product economically unviable for a provider. This reduces competition, to the detriment of customers. Indeed, in discussions on the design of the Pan-European Pension Product (PEPP), we continue to advocate for the removal of advice from any fee cap to ensure it can be offered across the EU in a cost-effective and sustainable manner, whilst encouraging greater take up of the PEPP by European consumers.

Financial education:

Alongside measures specifically targeted at increasing the level of transparency about pensions at Member State and individual level, measures to improve understanding of financial markets and financial information help build consumer trust in capital markets, enable individual investors to make better informed financial decisions, and facilitate their wider engagement in capital markets. Increased financial literacy, including financial education campaigns at part of national school curricula and positive policy 'nudges' at important stages of life when individuals are receptive, will help to empower citizens and put them in control of their financial matters.

It is widely accepted that more financially literate individuals are more likely to improve their financial situation by putting long-term savings to better use. From a market perspective, increased financial literacy would result in higher retail investor participation which would help EU capital markets grow and increase the volume of funding available to the financing of the real economy. In particular, we agree that an EU framework on financial competence (for instance, on how to plan a budget, invest, borrow) should be developed to allow Member States to take it up in their education programmes and to provide the basis for a range of applications to be developed by public authorities and/or private bodies.

Provision of financial advice:

Providing high quality, reliable, and fair advice could contribute to increased participation of retail investors in capital markets. However, the HLF identified concerns that the payment of inducements to financial advisers may negatively affect the quality and objectivity of advice given to retail investors. Against this background, some HLF members have recommended that the payment or receipt of inducements should be banned to eliminate such conflicts of interest, while other HLF members oppose the introduction of a ban, pointing to a number of concerns about the effectiveness of such a ban and potential unintended consequences, including, for example, the risk of an 'advice gap' or a bias towards in-house products.

The IA supports the recommendation of the HLF that the Commission investigates the role of inducements in the adequacy of advice. In addition, more harmonised rules on inducements in sectorial legislation and better transparency of inducements received by distributors of investment products, with comparable rules for all such products, may allow clients to invest with more trust and make decisions in full knowledge of the associated costs and incentives. A certificate for financial advisors - and their better training - may ensure the adequate level of qualifications, knowledge and skills for professional advisors across the Single Market, hence enhancing professionalism and trust. It would also contribute to the level playing field between market operators offering services in the different Member States.

Creating a truly single market for capital

The HLF calls for smart regulation that will widen and deepen EU capital markets whilst preserving financial stability, market integrity, and investor protection. We agree any future proposal should follow a simplification objective in order to build a trust relationship with market participants. Citizens, companies and market participants expect the CMU to be a facilitator of market flows across the EU. As set out by Commission President Ursula von der Leyen, the future legislative agenda should be driven by the principle of "one rule in, one rule out".

Alleviating tax burden in cross-border investment:

Members States rightly see tax as a key fiscal tool within their arsenals, and historically Tax Policy has been one of the least harmonised aspects of the single market. Different administrative approaches by different tax authorities have created significant fragmentation across the EU in the taxation of dividends, interest and gains; and this has meant that tax compliance costs of cross border investment within the EU are some of the highest in the world.

Many of the systems employed by tax authorities are dated - paper-based and unsuitable for digitisation. They compare poorly against systems used internationally, and many emerging markets have been quicker to adopt new technologies and support reduced rates of double taxation through upfront relief rather than administratively difficult and lengthy reclaim processes.

The HLF calls for a common, standardised, EU-wide system for withholding tax relief at source. The IA welcomes the commitment to a common administrative system for withholding tax relief at the source, which will ensure that investors have access to the tax benefits they are entitled to through EU membership and under international law. A well-structured and well-defined withholding tax relief at source process that aims to ensure harmonisation across the EU will help reduce compliance costs for investors and tax authorities.

Supervision of European capital markets:

High-quality, well-resourced, and convergent supervision based on a single rulebook is often viewed as a key pre-requisite for a well-functioning CMU. However, it is our view that Europe's capital markets are still too fragmented to allow for centralised supervision and further regulatory harmonisation should be pursued before a competence transfer through an institutional change should be considered.

We believe that national authorities have the necessary expertise in supporting local ecosystems and transferring powers to an EU supervisor could risk rendering supervision more remote from citizens and local markets. In our view, there is no market failure that would merit a radical overhaul of the current supervisory architecture. Instead, the focus should be on ensuring consistency of supervisory outcomes for all markets through the strengthening of supervisory convergence.