

EUROPEANISSUERS VISION OF THE CAPITAL MARKETS UNION

The future of CMU from the perspective of companies

3 November 2016

Introductory remarks

Europe needs well performing capital markets to help companies to finance growth and innovation, which are both urgently needed in Europe. EuropeanIssuers has thus welcomed from the very beginning the European Commission's project of creating a Capital Markets Union (CMU), which would be able to foster the flow of capital throughout Europe. While we welcome the actions taken so far, we would take this opportunity, as end users of capital markets and financial services, to present our vision of what issuers truly want from the CMU and how our needs would best be taken into account.

Contributing to shaping the discussion on the CMU next steps is all the more necessary while faced with the great uncertainty in capital markets regarding the implications of the UK vote in the Brexit referendum on 23 June 2016. In this respect, we value the Commission's commitment to "accelerate delivery of the next phase of CMU action"¹ made in its communication of 14 September 2016.

For the success of the CMU, it is critical that the initial timeline and substance of the action plan be preserved and that the forthcoming proposals deliver practical, measurable outcomes to ensure that financial markets can provide the financing necessary for growth. In contrast to what has been done so far, a more horizontal perspective on several issues is needed, especially on how issuers interact with the financial system. In the following paper, we highlight a selected number of issues relating to four priority areas in which progress is required:

1. Attracting companies to the market;
2. Attracting investors to the market & promoting equity culture;
3. Removing national barriers to cross-border investments: the case of insolvency laws; and
4. Reviewing the Better Regulation Agenda in the wake of the recent consultation on the cumulative impact of the EU financial services regulation.

¹ Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions of 14 September 2016 CMU-Accelerating Reform – COM (2016), 601.

1. Attracting companies to the market

To promote the benefits of capital markets for the European economies, the regulatory environment plays a decisive role. In EuropeanIssuers' vision, a prerequisite for a Capital Markets Union is that the regulation of capital markets strikes the right balance between entrepreneurial freedom, investor protection and financial stability so that capital markets can be effectively used for the financing and risk management of European companies.

We therefore need to reduce compliance costs as well as any other unnecessary additional burdens for all companies. We should also make EU legislation more proportionate for small and medium-sized quoted companies and provide them with a simplified reporting model.

1.1 Reduce reporting requirements and administrative burdens for all listed companies

There is a need to reduce administrative burdens on companies and simplify reporting requirements while still providing meaningful information to investors.

Rules imposed on listed companies over the past decade and in the aftermath of the crisis have led to a massive increase of compliance costs and have consequently reduced the attractiveness of capital market finance. Issuers are faced with different layers of reporting requirements, resulting in a patchwork of different, often unconnected reports including financial statements, country-by-country reporting (CBCR) and environmental, social and governance (ESG) reporting. Companies try to address the needs of stakeholders by producing different reports whose scope and content are sometimes overlapping.

For instance, the proposed CBCR report for tax authorities alone will represent a significant challenge for companies, and it will take time to be adequately developed. Multinationals will face the practical requirement of reconciling public financial statements, legal entity books, local tax returns, and the OECD templates. This reconciliation process will be a difficult task for most companies, especially since the existing financial reporting systems for their subsidiaries are not designed to produce the necessary tax information, but only the information required for the parent company's consolidated accounts. In addition, requiring publication of confidential tax information under the Commission proposal on public country by country reporting of certain tax information undermines the competitiveness of European industry and can result in erroneous interpretations and reputational damage to companies.

Reducing administrative burdens and reporting requirements entails rebalancing investors' protection. The present patchwork of reports results in an excessively detailed and disheartening accumulation of information that investors do not read. The EU should adopt a different approach to helping investors to make informed investment decisions. Greater emphasis should be placed on protecting investors through the financial education. A more holistic approach is therefore needed to reduce reporting requirements and deliver more meaningful information to investors as opposed to adding to the existing patchwork of reporting requirements.

1.2 SMEs & Small and Mid-Size Quoted Companies

Capital markets need to be revitalised. They need to enable smaller companies to raise capital for investments in innovation and thus growth. The Commission is preparing a review of the regulatory barriers hampering access of smaller companies to public markets. We believe this is the right approach in order to make it easier for companies to raise capital on financial markets.

We welcome the Commission's commitment to working with the Member States. We expect this cooperation to harness the potential of the financial markets for small and mid-sized quoted companies, encouraging a capital market environment that is suitable for such companies seeking to raise equity finance for expansion.

Indeed, most SMEs continue to be dependent on banks and seek external financing in a purely national context. Therefore, the CMU initiative is likely to have an important impact essentially on high-growth and medium-sized companies by improving their access to financial markets.

With a view to enhancing market financing for smaller companies, the Commission's support for them should be provided both directly, by promoting the use of dedicated platforms (SME Growth Markets) and indirectly, by developing pan-European products for smaller companies, including covered bonds, for which the Commission has taken a welcome initiative, asset-backed securities and corporate bonds.

To achieve this vision, the EU should promote a more proportionate legislation vis-à-vis smaller quoted companies under every piece of EU legislation and enhance market-based financing for SMEs and high-growth companies.

1.2.1 A single definition of Small and Mid-Size Quoted Company

There is no single legal definition of a small and mid-size quoted company in the EU. A single definition (or asset class) for these growth companies is needed so that regulations can be focused and proportionate. Small and mid-size quoted companies are fundamentally different from large blue chip companies (e.g., in terms of their growth potential, size, turnover, market capitalisation, job creation, percentage shareholding of investors, and types of investors, among others). As such, they require a different regulatory and market ecosystem. However, since there is not a definition, there are not any appropriate, tailored rules for these companies' growth needs.

We would propose carving out a definition of growth companies (which could be linked both to the size and to the period of listing), which would benefit from a simplified regime that would gradually encourage small and mid-size quoted companies to grow. This could include an additional transitional simplified regime applicable for a definite period of time (e.g. the first 5 years of listing). We strongly believe that the current regime is damaging growth potential, and hence there must be different regimes applicable to companies' different stages of growth. We must add that policy initiatives targeted towards the smaller companies should not be restricted to SME Growth Markets as there is a significant number of smaller listed companies on regulated markets.

1.2.2 Across-the-board reduction of administrative burdens

A good example where current regulation has increased administrative burdens for smaller companies is the extension of the scope of application of the Market Abuse Regulation (MAR) to trading platforms beyond regulated markets. The extension has substantially increased the level of regulation for smaller quoted companies, which are typically listed in the respective segments, as these companies now have to compile insider lists, notify managers' transactions and comply with the duty to publish inside information.

Specifically on insider lists, MAR recognises that the requirement to produce and keep insider lists is too onerous for small and mid-size quoted companies, and thus includes an exemption for issuers on SME Growth Markets from producing an insider list. However, "SME Growth Markets" are defined in MiFID II, which means that this exemption will not apply until MiFID comes into force and growth markets throughout the EU become SME Growth Markets.

By having the MiFID II requirements come into force after the entry into force of MAR, the EU has effectively removed the necessary exemption for growth companies, which will need to put systems in place for insider lists and be subject to rules that require the same level of information from larger companies with different resources.

1.2.3 SME Growth Markets

SME Growth Markets benefitting from more favourable rules will become an opportunity not only for SMEs but also for the development of capital markets and the economy as a whole. SME Growth Markets have the potential to become the remedy to existing obstacles to market financing for SMEs: unhealthy ecosystems, difficulty in attracting companies to financial markets and raise funds, lack of clarity of the growth market's vision, rules and structure for the future. Therefore, it is crucial that the rules for the functioning of SME Growth Markets—as well as the proportionate legislation applicable to issuers on those markets—strike the right balance. We would be happy to work with the Commission to develop a vision for SME Growth Markets.

1.2.4 Accounting standards for SME Growth Markets

The Commission is exploring with the International Accounting Standards Board (IASB) and stakeholders the possibility of developing a voluntary tailor-made accounting solution for companies admitted to trading on SME Growth Markets.

We believe, however, that it would be unhelpful to develop and adopt another set of accounting standards for Multilateral Trading Facilities (MTFs) or SME Growth Markets. This new set of accounting standards—coexisting alongside International Financial Reporting Standards (IFRS) and national standards—would increase market fragmentation, add complexity and decrease comparability. We firmly believe that companies on SME Growth Markets and MTFs should have the choice to use their local accounting standards (GAAP) or full IFRS.

2. Attracting investors to the market & promoting equity culture

To channel more funds towards capital markets, we need to review prudential requirements for institutional investors, incentivise investment in equity and create a tax framework for savings and capital gains.

2.1 Prudential requirements

The Solvency II capital requirements for insurance companies need to be revisited. The regime created by Solvency II in its latest form creates disincentives for insurers to invest in riskier asset classes, including equity. It also gives preferential treatment to shorter maturities and does not sufficiently recognise the longer-term nature of insurers' liabilities, which play a central role in helping subscribers save for retirement. Therefore, there is a need to review Solvency II to better balance the solvency of insurers and to promote investments in equity and long-term market segments, going beyond the recently announced proposal by the Commission concerning investment in infrastructure.

Similarly, the capital requirements imposed on credit institutions under the Capital Requirements Directives (CRD) IV has negatively impacted their financing capability and their role as investors in financial markets, notably in the field of financial instruments covered by the CMU project (investments in equities, listed or not, securitised assets or infrastructure). This has led several institutions to reduce their activity on financial markets (e.g. market-making) to the detriment of investors and issuers. While supportive of the objective to have sound and stable financial institutions, we consider that the key issue is to strike the right balance.

2.2 Incentives for increased equity financing

Encouraging investors to channel more funds towards equity will require the change of saving behaviours. The preference of retail investors in Europe for liquidity and short-maturity instruments seems to be deeply rooted in risk-averse behaviours and promoted by tax and regulatory policies, especially in some Member States. These policies need to be altered to change these financing patterns and encourage long-term investment in capital markets.

In addition to retail investors, institutional investors must also contribute to the development of long-term financing of the economy. To that effect, the EU should also consider the specificities of long term financing in EU prudential regulation and rules. In this respect, we draw the Commission's attention to the shortcomings of the European Long-Term Investment Funds ("ELTIFs")², created to favour long-term investment (especially in infrastructure and medium-sized companies). ELTIFs will largely remain an empty shell if the capital requirements associated with ELTIFs are not directly linked with the underlying exposures of the fund.

² The ELTIF Regulation was adopted on 20 April 2015 by the Council

2.3 Tax measures

To create growth and jobs via capital market financing we need to promote equity in companies. It is therefore crucial to reduce the tax burden on equity and, in this respect, we would like to point to national systems that are working well using the so-called “notional interest deduction” on equity. We therefore welcome the intention of the Commission in its communication of 14 September 2016 to address this issue.

We also urge the EU to renounce the proposal to create the European Financial Transaction Tax (FTT), which would harm the functioning of the securities and derivatives markets and is likely to result in a decrease of liquidity in stock markets thereby creating additional hurdles for companies using capital markets as a source of finance.

3. Removing national barriers to cross-border investments: the case of insolvency laws

The Commission has announced in its communication of 14 September 2016 that it will present shortly a proposal on “business restructuring and second chance” incorporating key elements of an appropriate insolvency framework. Recent studies on the economic impact on insolvency reform in the EU suggest that the potential gains from agreeing on common principles would be huge³.

Harmonising insolvency laws is a difficult process, as these laws interact with a myriad of other local laws, corporate and labour laws (especially employees and creditors’ rights). We therefore welcome a more principle-based approach which, without entering the details of local legal frameworks, may cover the following elements:

- Initiate as early as possible a process to assess companies’ viability and distinguish between firms that have a genuine potential to remain viable from those which do not;
- Facilitate early restructuring of viable businesses and enable them to return to normal operations as soon as possible;
- Provide legal certainty by ensuring that all parties have a clear understanding of procedures, timelines and their rights and responsibilities; and
- Facilitate and expedite the settlement of claims.

4. Reviewing the Better Regulation Agenda in the wake of the recent consultation on the cumulative impact of the EU financial services regulation

The rationale for last year’s call for evidence was to better understand how the various rules in the financial services area interact and how to make them more user- and growth-friendly. The feedback to the call confirms that there are significant overlaps and inconsistencies between various pieces of

³ According to a study released in February 2016 by AFME, if all EU member states were to reach a recovery rate of 85 percent, this would imply a permanent increase in GDP between 0.3% and 0.55% of EU28 GDP.

financial markets legislation. But we fear that the response of the Commission would not live up to the challenges posed by the call on two accounts:

4.1 Issuers' perspective on CMU

First and foremost, we believe that the call for evidence fails to reflect the perspective of issuers as end users of capital markets and financial services, besides its orientation towards the financing of companies. What the Commission envisages as next steps is making the EU legislation more proportionate, but only for the financial industry. Issuers need their interests and views to be better taken into account and the regulatory framework to strike a better balance so that capital markets can effectively be used for the purpose of efficient corporate finance and risk management.

To maximise the efficiency of the CMU from the issuers' standpoint we recommend using the following principles as guidance when reviewing existing regulations or drafting new ones:

- **Flexible access to capital markets:** EU companies of all sizes and at different stages of growth should have access to an appropriate market types in the EU, depending on their size, complexity and fund-raising ambitions. Access requirements must be proportionate, as targeted as possible, and develop ways that minimise costs and complexity;
- **Use of risk management services:** non-financial companies use OTC derivatives to hedge commercial risks (fluctuations in exchange rates, interest rates or commodity prices). The current legislative framework (EMIR) partially exempts non-financial companies from the centrally-clearing obligation, which is absolutely justified, as such transactions are necessary to the normal conduct of business and do not expose non-financial companies to unmanageable liquidity risks.

We thus urge the European Commission not to follow ESMA's advice to oblige larger non-financial companies, using derivatives almost exclusively for risk mitigating purposes, to clear centrally. We also call on the European Commission to ensure that the guiding principle in EMIR, recognising that the use of derivatives instruments for risk management of non-financial companies is beneficial, be applied also to other regulatory initiatives.

- **Dialogue with investors:** companies want to be able to communicate with the person who ultimately owns their shares or the person to whom the owner has delegated decision-making power. There should thus be effective communication along the investment chain from issuer to investors. Issuers therefore need an effective shareholder identification regime, which is far from being the case under the draft legislation amending the Shareholders Rights Directive.

4.2 Better Regulation

To achieve consistency of new regulation, both with the *acquis* and international guidance, we believe that the Better Regulation principles adopted by the Commission in 2016 should be strengthened along

the lines of the proposals made in an EP report⁴ released two years ago, to better handle the shortcomings in the EU decision-making process. We therefore urge the Commission to adopt an ambitious program with additional details attached in the Annex.

⁴ European Parliament, Committee on Economic and Monetary Affairs, « Enhancing the Coherence of EU Financial Services Legislation», PE524.618v01-00, 10 February 2014.

ANNEX

Better Regulation principles

We believe Better Regulation principles should be applied to:

1. Make the EU *acquis* simpler before considering any new initiative and consider the latter only where its necessity is evident. Consequently, it is crucial to define the right balance between harmonisation and national specifics; having a level playing field in place should not be an end in itself. The EU constituting element is subsidiarity. From that perspective, a CMU may not necessarily need complete harmonisation.

A good example is the intention of the Commission to consider, on the basis of a study to be released shortly, whether there is a case for an EU initiative aiming to harmonise securities ownership rules. Differences in national ownership regimes within the EU do not create legal uncertainty and there is accordingly no need to harmonise the exact legal nature of the investor's rights in the securities. In each European jurisdiction, investors purchase securities and pay the price to acquire in rem rights in securities as they have been created under applicable law and on equal terms with domestic investors. The exact legal nature of those in rem rights may vary among Member States; however, the acquisition of an in rem right appears in all European jurisdictions. The problem lies elsewhere and stems from the way collateral is being used; the main risk is that the same securities are being used to support multiple transactions.

2. Encourage the Commission to carry out co-ordinated reviews of existing legislation;
3. Develop financial markets legislation in a coherent form by enhancing the Commission's guidelines on impact assessment to identify the interactions between the proposed legislation and comparable issues in related legislation. A case in point is the proposed legislation on a public CBCR, which fails to comply with the Commission's existing guidelines on Better regulation;
4. Consult industry on a range of horizontal issues which have a significant impact on the effect of the legislation (e. g. Proportionate regime and SMEs);
5. Co-ordinate drafting and passage of related legislation. The Commission should consider the value of having horizontal approaches on a certain number of issuers;
6. Improve the coherence and co-ordination not only within the EU *acquis* but also between the EU rules and those recommended by international organisations (G20; Basel committee on banking supervision and IOSCO);
7. Improve the consistency between Level 1 and Level 2 measures. In recent years, in many cases Level 2 measures haven't been consistent with the political will set out on Level 1. To remedy this development, two separate issues need to be addressed:

- Firstly, the EU legislator must refrain from overcoming political deadlocks by delegating crucial decisions which need to be taken on Level 1 to Level 2.;
- Secondly, European Supervisory Authorities (ESAs) need to respect the political will expressed in Level 1 regulations when drafting legislative acts. Compliance can be enhanced in that regard by improving governance and accountability of the ESAs. The upcoming White Paper on the governance, accountability and funding of the ESAs constitutes an excellent opportunity to act in this regard.

EuropeanIssuers is a pan-European organisation representing the interests of publicly quoted companies across Europe to the EU Institutions. There are approximately 13,225 such companies on both the main regulated markets and the alternative exchange-regulated markets. Our members include both national associations and companies from all sectors in 14 European countries, covering markets worth €7.6 trillion market capitalisation with approximately 8,000 companies.

We aim to ensure that EU policy creates an environment in which companies can raise capital through the public markets and can deliver growth over the longer term. We seek capital markets that serve the interests of their end users, including issuers.

For more information, please visit www.europeanissuers.eu.