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FESE Response to the European Commission's consultation paper on the Green Paper on Capital Markets Union

1. INTRODUCTION

The Federation of European Securities Exchanges (FESE) represents 36 exchanges in equities, bonds, derivatives and commodities through 19 Full Members from 30 countries, as well as 1 Affiliate Member and 1 Observer Member. FESE is a keen defender of the Internal Market and many of its members have become multi-jurisdictional exchanges, providing market access across multiple investor communities. FESE represents public Regulated Markets. Regulated Markets provide enterprises with the means to access capital through listing by bringing together enterprises and investors in a transparent and secure manner. Securities admitted to trading on our markets have to comply with stringent initial and ongoing disclosure requirements and accounting and auditing standards imposed by EU laws. Furthermore, Regulated Markets also provide a secondary market where securities are sold and transferred from one investor to another for both institutional and retail investors providing them with transparent and neutral price-formation.

At the end of 2014, FESE members had up to 9,051 companies listed on their markets, of which 7% are foreign companies contributing towards European integration and providing broad and liquid access to Europe's capital markets. Many of our members also organise specialised markets that allow small and medium sized companies across Europe to access the capital markets; 1,442 companies were listed in these specialised markets/segments in equity, increasing choice for investors and issuers. Through their RM and MTF operations, FESE members are keen to support the European Commission's objective of creating a single market in capital markets.

FESE members are pleased to have the opportunity to contribute to this public consultation on Capital Markets Union Green Paper.

FESE would also like to bring to the attention of the Commission the recent publications that deal with the issue of Capital Markets Union:

- FESE Blue Print Agenda[1]
- IPO Task Force[2]

[1] http://fese.eu/images/documents/position-papers/2014/141125_FESE%20BluePrint.pdf
[2] http://fese.eu/images/documents/speeches-reports/2015/Final_report_IPO_Task_Force_20150323.pdf

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2. Executive Summary

2.1 Recognising & underpinning the role of public capital markets in CMU

It is clear that Europe needs to finance investment, create jobs and wealth, **and boost economic growth.** The European Commission estimates the overall investment needed for transport, energy and telecom infrastructure networks of EU importance amounts to **1 trillion EUR for the period up to 2020**[3]. About **6 million European jobs** have been lost because of the financial crisis. While much progress has been made since the peak of the financial crisis[4], we are far from being on a path of continuous growth. Fostering innovation offers the best opportunity for growth and employment in Europe.

A successful CMU needs to increase the size of public markets to 100% GDP by 2020.

In an environment in which Europe needs to reduce its dependence on bank lending, economic development can only be financed through a greater share of financing from capital markets (which in our terminology includes both public capital markets and private capital markets, from here on to be referred to as **"market-based financing"**). The urgency of developing market-based financing has been recognised at the highest political levels in Europe, and most recently by the **European Commission President in his Political Guidelines for the European Commission**[5]**.**

More enterprise financing through capital markets will help Europe achieve higher levels of innovation, savings mobilisation, wealth distribution and job creation whilst ensuring an appropriate risk management framework. Market-based financing that appropriately assists smaller companies is especially effective in generating jobs: for every five jobs lost by large companies during the crisis in the four largest EU members, small and mid-sized firms created one new job[6] - which should be considered as a net positive. 92% of new jobs are typically created by companies after they list[7].

Yet, Europe's capital markets are far from meeting these needs. The EU's markets are falling in the global ranking, having slid from 2nd place behind the US to 3rd place behind the US and Asia[8]. Similarly, stock market capitalization is only 55% of the EU GDP, whereas bank credit to the private sector is 104% – almost the reverse of the ratios in the US, 136% and 43%, respectively[9]. By various indicators,

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[3] European Commission Communication on Long-term financing of the European economy, 27 March 2014. http:// ec.europa.eu/internal_market/finances/docs/financing-growth/long-term/140327-communication_en.pdf, page 2.

[4] http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=lfsi_emp_a&lang=en

[5] http://ec.europa.eu/about/juncker-commission/docs/pg_en.pdf

[6] http://files.gereports.com/wp-content/uploads/2012/06/TheMightyMiddle-GECapital.pdf
http://www.essec.edu/faculty/showRef.do?bibID=10477

[7] See Chart A: IPOs Finance Significant Job Creation, cited in rebuilding the IPO On-Ramp Putting Emerging Companies and the Job Market Back on the Road to Growth, http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf. Original data quoted comes from the Venture Impact 2007, 2008, 2009, & 2010 by IHS Global Insight; IPO Task Force August 2011 CEO Survey

[8] http://www.mckinsey.com/insights/global_capital_markets/mapping_global_capital_markets_2011

[9] European capital markets are much smaller than those of the US and are not growing at a sufficient speed to meet the economy's needs. According to a Bruegel Working paper, bank credit to the private sector as a percentage of GDP is 104% in the EU while it is 43% in the US. Conversely, stock market capitalization is 75% of EU GDP according to FESE statistics, whereas in the Working Paper it is 136% of US GDP. This is a fact recognised by the European Commission's Communication on Long-term financing of the European economy. While it is not reasonable to expect the share of European market-financing to resemble that of the US in a few years, it is clear that European capital markets need to grow further (in a sustainable and safe way) so that they can meet more of the needs of the economy. This is necessary above all because banks will face increasing difficulties to fund our economies. See "The Changing Landscape Of Financial Markets In Europe, The United States And Japan", Michiel J. Bijlsma and Gijsbert T. J. Zwart, March 2013.

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European markets fail to catch up with their peers from the Americas or Asia[10]. Out of the top 26 IPO markets, only six of them are from the EU (another two from the rest of Europe), and none of them in the top five[11]. In addition to the negative implications for economic recovery, these are also worrying indicators for **Europe's global economic power.**

As the operators of Europe's Regulated Markets, FESE members believe that **a fundamental reorientation of European policies is needed** to serve the original goals of the Single Market better at this current point in time. A re-orientation is critical to achieving the objectives of "Europe 2020", the EU's growth strategy for the current decade. Significant progress has been made, especially in terms of regulation (where rightly a lot of focus has been post-crisis). However, it will be crucial that the Capital Markets Union helps to move the pendulum towards more market orientation. FESE considers that more financing through capital markets helps achieve not just greater amounts of financing but also higher levels of innovation, efficient risk management, savings mobilisation, wealth distribution and job creation – which would serve the Union's 2020 objectives on employment, innovation, education, social inclusion and climate / energy.

In the initial 10-15 years of building the Single Market, the EU concentrated on policies that would foster the **integration** of its national financial sectors in order to create **one united European market** that would be efficient, deep, and competitive (e.g. in the image of the US market). The intention to integrate equities markets resulted in a major focus on reducing the transaction costs of trading of the largest stocks ("blue chips") which, it was assumed, would lower the cost of accessing capital markets (but there was no systematic measurement of the net effects on end-users in the real economy). **Cross-border competition** was the main tool to increase efficiency as experienced by the financial services industry. There was also limited discussion on what impact trading would have on the conditions for **listing** faced by companies, especially smaller ones.

FESE members – which traditionally operated nationally-based exchanges - endorsed the EU objective of creating a Single Market. They rose to the challenge through greater competitiveness and, in some cases, mergers or partnerships on a regional or transatlantic basis. Simultaneously they continued to fulfil their capital raising role in the national economies. Other important changes occurring in the same timeframe – in technology and market structure – also led to more pan-European trading, a greater concentration of broker and other services around blue chips, and a shift of trading and investment away from smaller companies.

[10] http://www.world-exchanges.org/files/statistics/pdf/2014_1H_WFE_Market_Highlights.pdf. Please note that the use of GDP as a denominator should be read in the context of different government spending across jurisdictions. Since government spending is a bigger share of GDP in Europe than in the US, this measure should be read together with other statistics. However, the distribution of enterprise funding sources in the US and the EU between banks and markets is also fully consistent with the GDP-based statistics.

[11] Paper commissioned by OECD, "Making Stock Markets Work to Support Economic Growth / Implications for Governments, Regulators, Stock Exchanges, Corporate Issuers and their Investors", David Weild, Edward Kim and Lisa Newport: http://www.oecd-ilibrary.org/governance/making-stock-markets-work-to-support-economicgrowth_5k43m4p6ccs3-en

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3. NEED FOR A NEW DIRECTION

FESE agrees with the proposed principles on which a Capital Markets Union should be based. We believe that policies undertaken in the past have helped increase the efficiency of trading, in particular in the largest companies, and as such have been effective. However, we believe that policies of the future should be underpinned by a new direction, which we summarise around these high-level principles:

- **A greater focus on the end-users of capital markets, i.e. COMPANIES and INVESTORS, and in particular on the core function of capital markets to finance growth**. A strong economy needs strong capital markets. Recent studies provide evidence that capital market size is positively correlated with economic development. The main function of markets is capital raising. Ideas need capital, and capital needs ideas. Markets exist for companies and investors. Hence, EU policies must focus on ensuring that capital markets provide companies with better access to capital and investors with diverse, transparent and affordable saving opportunities. If investors are educated, well-informed and well-protected, they will make responsible investment decisions from the range of available capital markets products, suited for their needs and risk profiles. Well-informed companies will search for the best funding possibility.

- **The EU Single Market must be ACCESSIBLE to companies at ALL LEVELS: national, regional and pan-European.** Pan-European market structures can offer greater efficiency through economies of scale and liquidity, and benefit many companies which want to and can access the wider investor pool. For this reason, we must continue to dismantle cross-border obstacles and remove barriers to harmonization (e.g. securities law, insolvency law, etc.). However, pan-European structures cannot be the only way of accessing the Single Market. Most companies start small, and are most attractive to investors in their immediate regional market. It benefits both innovation and employment when companies can access markets close to home before they reach a bigger scale that would be attractive at the pan-European or global level. Moreover, Europe will remain diverse in terms of languages, cultures, accounting and legal systems, economic bases and innovation clusters. Hence, European companies and investors need a combination of large, medium and small financial centres, all with corresponding ecosystems that cater for SMEs and investors.

- **A greater awareness of the importance of the DIVERSITY OF ECOSYSTEMS, and the way they are impacted by the interaction between listing and trading.** FESE members have operated successful models catering to smaller companies that combine their long experience serving their communities with new creative solutions. However, other institutions (such as small and mid-cap accountants, brokers, advisers, analysts, lawyers, etc.) are also needed to facilitate companies' access at the local and regional levels. However, these services catering to SMEs are disappearing (see Section 3). EU policies can make a difference in preventing a further erosion of the local and regional ecosystems. This requires policies that sustain the full spectrum of institutions serving smaller companies and their investors. For example, trading policies governing tick sizes affect economic incentives, which are vital for smaller brokers; policies determining when smaller shares can be traded on alternative venues affect liquidity, and ultimately the demand from investors. Keeping these ecosystems alive and fully effective must be the main goal.

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- **Ensure that all future rules are built on the principle of TRANSPARENCY and LEVEL PLAYING FIELD.** Future proposals to enhance the CMU must place emphasis on the positive effects of fair competition and follow the principle of a level playing field where no two competitors should be allowed to do the same business while being subject to different rules. Moreover, there should be a focus on trying to have a harmonised approach to all the relevant rules governing companies to access finance (tax systems, securities law, insolvency law, etc.). Regarding the proposed FTT, the Commission should analyse the impact that such an approach for only 11 Member states would have on the overall 28 capital markets.

In other words, our vision is that of capital markets which exist for issuers and investors above all other priorities. It is that of capital markets in which European issuers of different instruments and investors can meet one another at the level at which they are ready and willing to engage – be it local, regional, pan-European or global. In this vision, all policies are designed to help the capital raising function of markets for the benefits of economic growth. In these markets, any policy on trading is judged on how it affects the diversity of the financial services that exist to serve companies, other issuers and investors. In our vision, competition and efficiency are put to the service of the end-users of markets – the issuers and investors (both small and large) - while the EU creates the right conditions for national and regional ecosystems to serve their stakeholders and economies.

These principles will ensure that European capital markets are better adapted to the economic and political needs of Europe and better positioned to propel Europe into global economic leadership. This re-orientation will not only finance economic growth, but also enhance the credibility of the EU vis-à-vis its citizens and distribute the benefits of integration among all.

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4. FESE Recommendations

How do we achieve these principles? FESE believes that a holistic approach of industry and regulatory initiatives must be undertaken to strengthen the role of public capital markets within the CMU project in order to deliver the objectives of economic growth and job creation. In our view, the challenges facing public capital markets can be grouped under the following themes:

4.1. Strengthening European Public Markets' Culture;
4.2 Strengthening the Funding Escalator;
4.3. Promoting Equity Financing.

4.1 Strengthening European Public Markets' Culture

a. Europe must adopt a target for European capital markets' share of financing the economy:

(i) Capital markets must enable economic growth, and not constrain it. To meet the financing needs of the European economy in terms of long-term investment and employment, our capital markets must be sufficiently deep and diverse – and sufficiently large. The size of Europe's capital markets must be increased in relation to the GDP. An explicit political objective – e.g. "stock market capitalisation to account for 100% by 2020" - could be very useful in creating the momentum around the range of policies needed to increase the supply and demand within all sides of the market.

(ii) In parallel, we believe an assessment needs to be made of the ongoing costs of listing arising from mandatory regulation. Some of this is necessary to inform investors, but we would question whether the overall costs are too high.

(iii) The Commission must also adopt a "Think Small First approach" and to better understand the impact of how changes in technology and market structure have led to more pan-European trading, a greater concentration of broker and other services around blue chips, and a shift of trading and investment away from smaller companies that need financing.

b. Strengthen Europe's risk culture:

(i) Europe does not currently enjoy an 'equity culture' – listing on a public market does not have the positive connotations that it would in other markets. There is also a political ambivalence towards IPOs at the EU level, contrary to the US where the value of capital markets is seen as a benchmark for economic growth.

(ii) We strongly recommend the **fostering of a culture of risk-taking among SMEs and SME investors as a means to** create more balanced capital structures. Key to **influencing culture is education**.

c. Address fiscal incentives:

(i) A central obstacle to the development of public capital markets in Europe are some of the current fiscal arrangements in place. Today, the results of these arrangements are financial markets currently falling short of our vision due to a sub-optimal **equity vs debt** ratio. While we use the word "sub-optimal" with caution, it is clear that the equity part of the market is suppressed artificially by fiscal advantages given to debt instruments.

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(ii) **We support the City of London's International Regulatory Strategy Group in its call for** the European Commission to **conduct an assessment on the impact of the cost of capital in relation to the tax bias against equity.** Moreover, any new tax policy (including proposals such as the Financial Transaction Tax) which would discourage investors from investing in capital markets, in particular in listed instruments, should be avoided.

d. Deliver a true level playing field across European capital markets

(i) An overarching priority has to be the accomplishment of a true level playing field underpinning Europe's capital markets. Too often we witness fragmented and divergent application of European frameworks into national rules. In our view, the following changes need to be made: (i) change the legal basis of European frameworks from Directives to Regulations and (ii) explore all avenues through which ESMA can deliver consistent implementation of the rules across the Single Market.

e. Capital markets must become better at meeting investor needs:

(i) Investors with different time horizons and risk appetites use markets in different ways. Well-functioning capital markets should address all of these needs through a variety of robust financial instruments. Currently FESE members have a range of service offerings in place for market participants to choose from. Among others, markets must enable investors to plan for the future and provide for pensions: this means good growth potential and safety within their desired risk parameters. A core attribute of meeting investor needs is to be open to all investors and to treat them equally – without any segregation. All investors should have the ability to **access** financial markets in an equal way, and be adequately informed in order to decide which instruments best suit their investment needs. In particular, the increased difficulty of retail investors to be deemed eligible as qualified investors needs to be addressed.

(ii) We need to orient more investor flows into listed equity, bond and derivative instruments by **avoiding** any new or existing tax and regulatory **disincentives** that suppress investor demand (and, in selective cases, by considering whether to provide potential well designed tax incentives). Hence, we welcome the various steps announced in the Long-term Financing Communication concerning, for example, the Level 2 measures for Solvency II for infrastructure, SMEs and social businesses.

(iii) On the demand side, in addition to incentives, more investors must be able and willing to invest in markets. Financial consumer education plays a key role in encouraging more investors to invest in capital markets. Europe lags behind particularly in the share of investors in the equity and non-equity markets when compared with the US; in which the public opinion for capital markets remains positively associated with entrepreneurial dynamism.

f. Capital markets must finance all companies.

(i) Financial markets must serve companies both large and small, including those which are dynamic, innovative and growing. Financial markets must finance companies from the core to the periphery from East to West and North to South. Our capital markets must offer smaller companies the option of continuing to grow to a larger size in an independent way. This will boost innovation as well as local and regional employment. Key to this will be better financial education of growth companies together with more direct communication between

investors and issuers in the pre-IPO phase. Moreover, both during the pre-IPO stage and once listed, more needs to be done to connect companies with investors, for example via the creation of greater central public access to lists of investors active in given sectors.

g. A strengthened IPO process:

(i) As IPO costs are disproportionately higher for smaller companies, consideration should be given to find measures to reduce the overall cost of listing;

(ii) Encourage secondary raisings on public markets, focusing on making it easier for companies to issue equity and public bonds or undertake additional capital raising. Key focus will be on ensuring lighter disclosure rules where appropriate in respect of issuance, particularly in the context of the Prospectus Directive.

4.2 Strengthening the Funding Escalator

It is essential that a range of financing options flourish in Europe in order to provide a funding escalator accompanying growth companies through their development. However, today the ability of growth companies to move between different providers of finance along the escalator is often lacking. The reasons are two-fold:

(i) Firstly, there is a gap between what companies need at different stages and what the markets are delivering: more needs to be done to strengthen the private equity and venture capital segment, while investment-based crowdfunding needs to be appropriately regulated;

(ii) Secondly, companies need to be better informed as to how to access different sources of finance.

We call on policymakers to recognise the importance of the DIVERSITY OF ECOSYSTEMS, and the way they are impacted by the inter-action between listing and trading. FESE members have operated successful models of services catering to smaller companies that combine their long experience serving their communities with new creative solutions. However, other institutions (such as small and mid-cap accountants, brokers, advisers, analysts, lawyers, etc.) are also needed to facilitate companies' access at the local and regional levels. However, these services catering to SMEs are disappearing.

EU policies can make a difference in preventing a further erosion of the local and regional ecosystems. This requires policies that sustain the full spectrum of institutions serving smaller companies and their investors. Examples of such policies are: trading policies governing tick sizes affect economic incentives, which are vital for smaller brokers; and, policies determining when smaller shares can be traded on alternative venues affect liquidity (including market making schemes), and ultimately the demand from investors. Keeping these ecosystems alive and fully effective must be the main goal.

Encompassing these recommendations are two further principles which need to be underlined. Firstly, **EU Capital markets must be well-regulated, transparent, fair, and not reliant on taxpayer money.** Market-financed growth must be accompanied by sustainability and safety. Capital markets that provide opportunities to finance issuers are only attractive to investors if they are well regulated and transparent and if systemic risk is properly monitored, hence, our markets must have high levels of market integrity and appropriate measures for safety. Secondly, **EU capital markets must be**

accessible to the world and be seen as a desired model. The EU is a model to emulate for many regions of the developing world. European capital markets must remain open to 3rd countries' investors, issuers, and financial institutions. While avoiding extraterritoriality, Europeans should continue to promote the European regulatory model as best practice around the world whenever appropriate.

4.3 Promoting Equity Financing

Improved access to equity financing should be one of the main cornerstones of CMU, given its beneficial characteristics. Many different types of equity financing exist, for example:

- Business angels – wealthy individuals (often entrepreneurs) financing start-ups;
- Venture capital – specialist funds providing capital to early-stage, high-potential, growth start-up companies;
- Crowdfunding – funding by collecting (small) monetary contributions from a large number of investors, typically via internet platforms;
- Initial public offerings (IPOs) – the first issuance of equity by a company to the public.

In comparison with the US, Europe is weak at raising capital through these channels and at helping small entrepreneurial SMEs to grow. The CMU would be well placed to incentivise equity financing via venture capital firms, crowdfunding and business angels to help companies grow faster. This could be done through the careful provision of harmonised government support to start-ups to help them raise capital more easily (e. g. through tax breaks for investors).

At a more mature stage equity financing through an IPO becomes an option. The primary advantages of an IPO are that it enables companies to raise additional equity capital while giving the original venture capitalists the opportunity to exit through the secondary market. Moreover, it is a form of publicity for the company and serves to distribute the equity capital among a broader shareholder base.

In order to promote IPOs as an alternative funding source, and open it up to SMEs in particular, it will be necessary to better coordinate the pre-IPO phase. With exchanges increasingly broadening their roles as part of the capital market "ecosystem", market infrastructure could be used to fill the existing transparency and efficiency gap between all relevant constituencies in the IPO set-up phase. Exchanges are responding to these challenges with a variety of diverse initiatives to better coordinate the pre-IPO phase.

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3. FESE RESPONSE TO THE COMMISSION CONSULTATION

- **SECTION 2: CHALLENGES IN EUROPEAN CAPITAL MARKETS TODAY**
- **SECTION 3: PRIORITIES FOR EARLY ACTION**

Q1: Beyond the five priority areas identified for short term action, what other areas should be prioritised?

FESE believes that the Green Paper does not recognise the need to increase the attractiveness of public markets for rasing capital. While bank financing compared to other geographies is well developed in Europe, public markets should become a much large source of funding in a successful CMU. FESE urges the Commission to put in place an action plan to increase public financing, both in terms of short-term & immediate issues, and long term objectives. These priorities are as follows:

1. **Short-term/immediate priorities:**
   - (i) Conduct a series of impact assessments to identify and support policy initiatives that will deliver real benefits;
   - (ii) Avoid introducing overlapping legislation on market data;
   - (iii) Analyse fully the potential impact of the FTT.

2. **Long term objectives:**
   - (iv) Increase the role of public markets;
   - (v) Increase the transparency of European Derivative Markets;
   - (vi) Rebalance the fiscal treatment of equity vs debt;
   - (vii) Address the bias against investing in equity in Solvency II.

(i) Conduct impact assessment to avoid making mistakes in existing legislation

There should be a comprehensive impact assessment undertaken to avoid unintended consequences of existing legislation. This not only means analysing the increased market complexity, but also the impact it has had on the trading of small and mid-caps. The US, which has a market structure that is generally accepted as being too complex, is on a path to review its structure to reduce this complexity. While we have so far avoided the same level of complexity in Europe, many investors complain that transparency has decreased and cost of complexity has increased after the introduction of MiFID I. The way MiFID II is implemented will determine the evolution of our markets to a large extent. For example, the regulation of best execution in Europe is superior to the US approach because it minimises complexity while meeting the diversity of investor needs. However, the best execution policies need to be transparent and enforceable.

Therefore, the Commission must pay close attention to the final provisions it is implementing with regards to MiFID II. In particular, the impact that the increased market complexity and introduction of less transparent market infrastructure, such as Systematic Internalisers has had on the local eco-systems.

(ii) Market Data is the wrong focus to promote the CMU

FESE questions why the issue of Consolidated Tapes is included in the concept of the CMU. The consolidated tape will be addressed by MiFID II. Article 90.2 even includes a review clause on the effectiveness of the CTP regime. In case no consolidated data / Consolidated Tape – in the form as required by legislation now – is made available, MIFID II already foresees a public procurement process for the appointment of a commercial operating entity. Additionally, as of today, MIFID II foresees that data is being made available at reasonable commercial terms. To avoid double regulation we recommend to remove this element from the CMU policy initiatives under consideration as follow-up to the Green Paper.

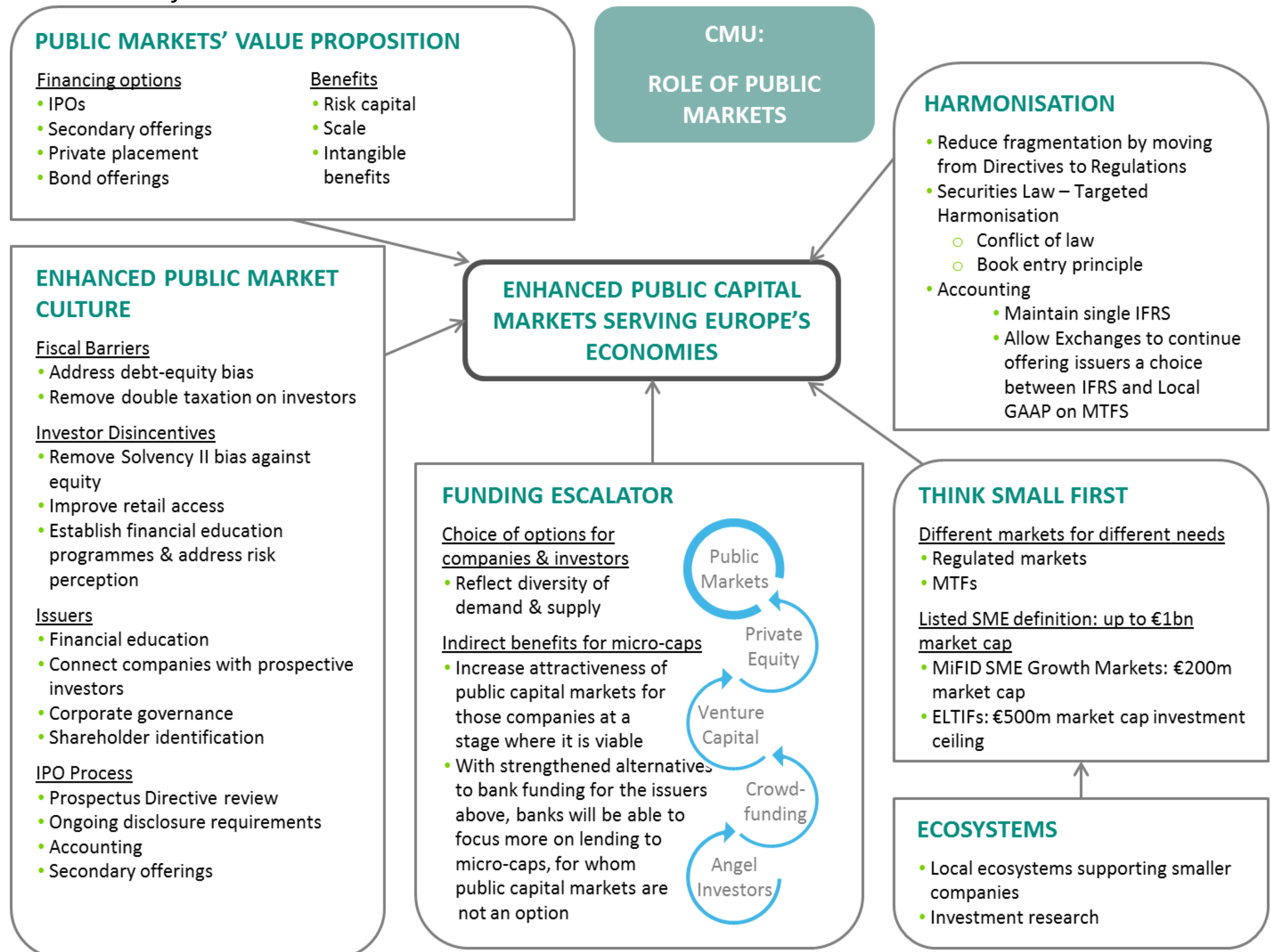
(iii) Analyse the consequences of an FTT

We strongly oppose any FTT on the grounds that it will simply increase transaction costs and therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital-raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. Moreover, we consider that the introduction of an FTT in 11 Member States would contradict any moves towards the harmonisation of tax rules. In this regard, it is important to consider that many capital market funding options would be eligible for taxation.

(iv) Increase the Role of Public Markets

Capital markets play many beneficial roles in an economy which are vital to economic growth. In particular, public equity markets have the unique ability to finance risk capital, which is the main source of innovation. Capital markets also allow issuers and others to manage risks (especially in the case of on-exchange derivatives); mobilise savings for households (through direct and indirect investments); distribute the benefits of economic progress among broad parts of the population; and generate long-term employment.

Chart 1 Role of Public Markets



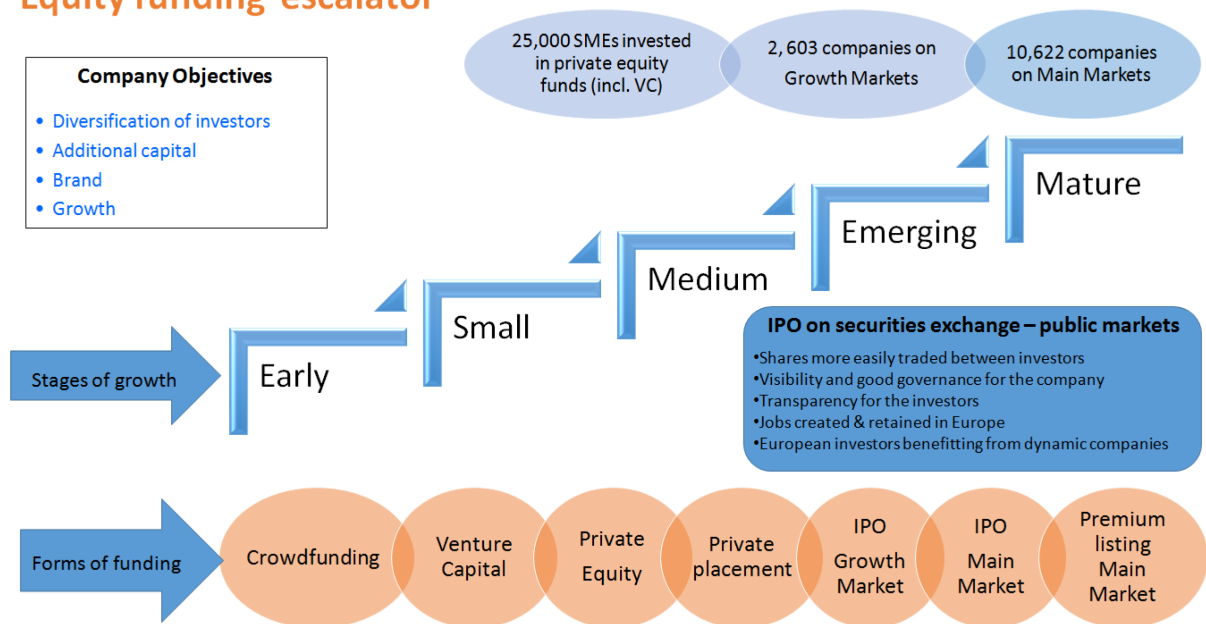
As a sub-set of capital markets, public and open capital markets have a core function which is intrinsically linked to equitable and sustainable growth. Exchanges are a crucial part of Europe's capital markets and they are part of a complex and delicate **ecosystem** of numerous important players – brokers, banks, advisers, analysts, auditors, lawyers, etc. – who must all come together to serve enterprises and households in all the different ways in which the economy needs capital markets (financing, saving and risk management).

Furthermore, public equity markets are not only important on their own, but play an important role in the "funding escalator" with different modes of financing for companies at different stages of development. For example, **IPOs, through their role as an exit for venture capital, become a positive contributor to the funding of innovation**.

Before entering the public equity markets, companies may obtain private equity capital from crowdfunding, venture capital and private equity. Once companies have joined the public markets,

they may still be able to climb the funding escalator via access to exchange-regulated or Growth Markets, the main EU Regulated markets, and segments within those markets.

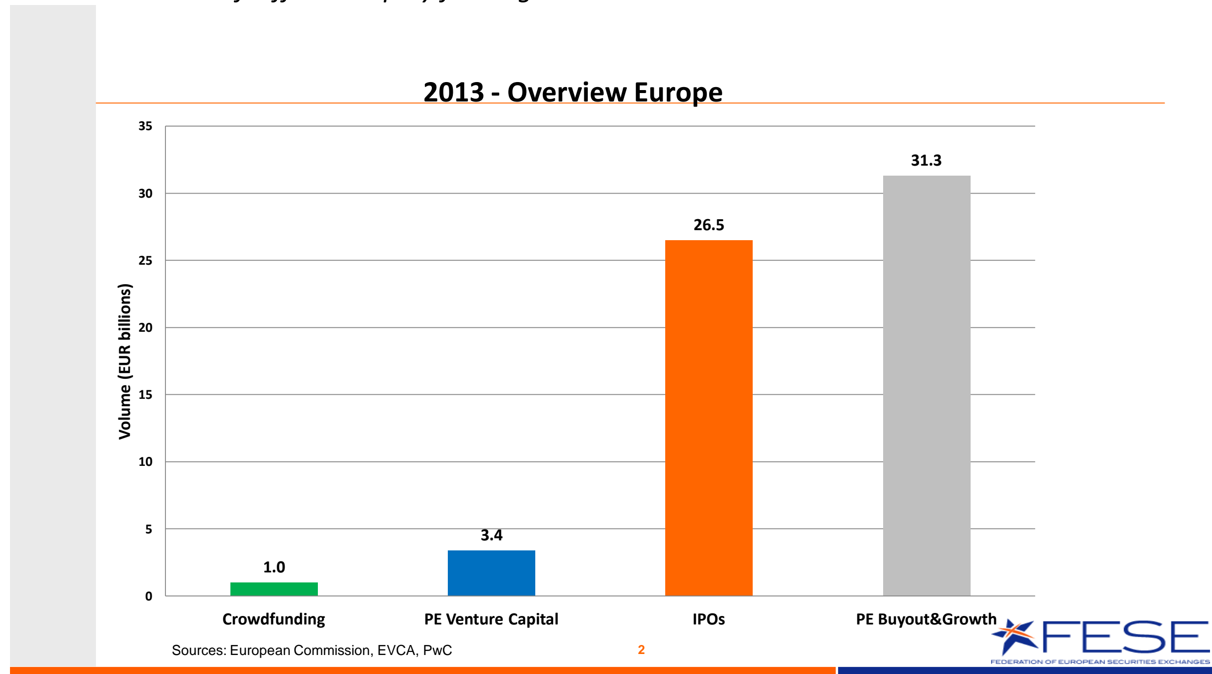
Chart 2 The Funding Escalator



Source: FESE stats, LSE and Borsa Italiana stats

It is important to note that different venues exist for different stages of development (not necessarily in a sequential way, but sometimes in an overlapping way). The following chart shows the amount of funding available collectively from these sources.

Chart 3 Overview of different equity funding models



Source: FESE

Moreover, public markets also play an important social role by allowing broad groups of investors to benefit from the long-term profitability of dynamic companies. More broadly, public equity (and non-equity) markets promote stability because of the high standards of corporate governance, transparency and supervision underlying to the instruments issued. The transparency that comes with being listed enhances the quality of the management of a company and also prevents a company from losing its entrepreneurial focus on its corporate goals. Therefore, transparent public equity markets must be favoured over private markets in order to ensure that there is suitable disclosure to investors..

Capital markets must enable economic growth, and not constrain it. To meet the financing needs of the European economy in terms of long-term investment and employment, our capital markets must be sufficiently deep and diverse – and sufficiently large. **The size of Europe's capital markets must be increased in relation to the GDP**. An explicit political objective – e.g. "stock market capitalisation to account for 100% of GDP by 2020" - could be very useful in creating the momentum around the range of policies needed to increase the supply and demand sides of the market.

To increase public financing, we believe that regulators should focus on the following measures:

1) Developing initiatives to revive investor trust;
2) Further harmonisation/removal of barriers;
3) Avoid regulatory arbitrage on a global level;
4) Increase role of derivatives markets for risk mitigation

(v) Increase Transparency of European Derivative Markets
Derivative markets play a crucial role in financing the economy. Europe is home to some of the world's largest and safest on exchange derivative markets, which enable the risk management for a diverse range of enterprises as well as investors. As the crisis has shown, on-exchange derivatives are very positive for the economy. For many decades, derivatives of various kinds have played a very positive role in the world economy. FESE fully supports any policy initiatives taken to address market deficiencies unveiled by the financial crisis which should target improving the safety and integrity of derivatives trading and clearing while maintaining their positive contribution to the economy and the financial sector.

FESE members play an important role in the global derivatives market. They operate well-regulated, transparent, technologically advanced trading (and in some cases clearing) arrangements with a proven value proposition and track record in safety and reliability. It is the wish of derivatives exchanges to maintain the highest standards of safety and integrity, as well as efficiency and competitiveness, in the trading of derivatives in a global marketplace. Regulated markets ensure that all derivatives trades are cleared through central counterparties. As was the case for fixed income, the crisis has shown that transparency is a vital element of well-functioning derivative markets, even and perhaps especially during periods of stress. On-exchange trading has been proven to perform in extreme conditions like the recent financial turmoil, when the Lehman Brothers' outstanding positions where closed out within hours. Trading via regulated exchanges cleared into central counterparties mitigate counterparty risk, increase liquidity, allow for sound margining and risk control requirements over clearing house members, increase transparency on open risk positions and provide records on OTC derivative transactions. In addition they offer greater risk reduction benefits, particularly in terms of increased liquidity in moments of stress in OTC markets.

Hence, OTC derivatives have been put on a path of standardisation and clearing to ensure that derivative markets as a whole pay a positive role. In this sense, the size of derivative markets in Europe is generally satisfactory when measured against the needs of the economy, but the share of on-exchange vs OTC should (and will) increase as a result of the policy changes in motion.

(vi) Rebalance the treatment of equity vs debt
Rebalancing the current bias towards debt financing should be an important initiative for the CMU for two reasons. Firstly, it may encourage companies to strengthen their equity base and discourage levels of leverage that are too high, thereby improving their financial stability via increased loss absorption capacity. Secondly, it may result in investors paying lower taxes on their equity investments, incentivising provision of equity capital as an alternative funding source.

There is also wide variation in the gap between effective marginal tax rates on debt and equity-financed investments. According to the International Monetary Fund, this gap ranges from 10 to 50 per cent for European countries. Therefore, it is not only important to rebalance this bias, but also to harmonise tax procedures within Europe, in order to create a level playing field. An additional point to consider is that this bias is even more pronounced in the US than it is (on average) in Europe. As a result, rebalancing the bias across Europe in the form of a reduction in the tax on equity investments might serve to increase the attractiveness of investing in the region.

(vii) Address the bias against investing in equity in Solvency II

We have concerns about regulatory restrictions, for Solvency II in particular. Under the new Solvency II regime insurers must, in principle, hold a 39% capital charge for owning shares in listed companies in the developed markets and a capital charge of 49% for other categories of shares. Depending on the (exceptional) development of share prices, the regulatory authority has the power to adjust this capital requirement upwards or downwards by no more than 10%. A capital charge of 22% applies to participations of a strategic nature. Debt-related instruments are potentially less expensive and they are subject to a capital charge of 15%.

There is no capital charge whatsoever for treasury bonds issued by Eurozone Member States. Since insurers and possibly regulatory authorities as well are already anticipating the new rules, insurers are in the process of disposing of a significant volume of the equity investments that they hold at their own expense. Some insurers have completely stopped investing in equities, which means that equity funding via the capital markets may not be an option for as many companies, while at the same time as bank funding may be scaled back.

Q2: What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?

1. **Need to further define the scope of relevant companies**

FESE consider that the CMU Green Paper should have an increased focus on capital market funding. Therefore, we believe that consulting only on credit information is a too limited approach and that there is a need to improve the availability of all information on capital market oriented companies in order to allow easier access to capital markets. The Commission must take into account that any 'widening' of information available must be understood as looking beyond credit information. FESE considers that currently the data available on SMEs is very limited and needs to be much broader and standardised to enable investors to easily understand the company. The information that should be made available must be linked to the Prospectus Directive (PD) where possible, but only in respect of Regulated Markets listings. The PD consultation has a proposal for a filing system for prospectuses which could be linked to this issue and ESMA could encourage SMEs to start filing key information much earlier in their life cycle.

From a conceptual point of view, we also believe it is important to recognise that all existing SME definitions include a large number of companies, almost 20 million, unlikely to ever tap capital markets. In respect of the SME and midcap companies, we believe that the focus of CMU should be on strengthening the ability of those companies within this broad group which ***are actually likely to want to access capital markets***. The existence of a broad group of 20m SME companies can blur the importance of focusing on the smaller group of innovative and fast-growing start-ups with a high potential which need better access to capital markets. To put this into context, there are 11 000 companies currently listed on public markets, and approximately 30 000 – 40 000 companies that rely on business angels, crowdfunding, venture capitalist for funding.

A report by Oliver Wyman[12] notes that while today only 5% of European SMEs issued tradable equity and 2% issued debt, up to **20% of SME funding** could be sourced from capital markets. This is critical since job creation is strongest among SME and mid-cap enterprises. A European study by the ESSEC Business School and GE Capital[13], covering France, Germany, Italy and the UK for the period of 2007 to 2010, showed that, while these companies represent a tiny fraction of total companies – ranging from a low of 1.2% in Germany to 1.7% in France – they generate about one third of private sector revenue and employ about a third of each country's workforce.

Critically, it is important to acknowledge the likely limits on access to public capital markets for the smallest European companies, i.e. the **micro-enterprises that make up 90%.** However, were CMU to deliver an expansion of access to capital markets for large SMEs and mid-sized companies, this would benefit not only those companies directly, but also – *indirectly* – the smaller SME micro-enterprises via the freeing up of additional bank lending[14]. This would recognise the fact that while the overwhelming majority of companies in Europe fall into the micro-enterprise category (i.e. companies with fewer than 10 employees), companies with market caps of up to 1bn Euros still tend to rely on bank lending. It is this group, and particularly the innovative and fast growing startups which need to be the priority for CMU.

Q3: What support can be given to ELTIFs to encourage their take up?

ELTIFs by design are permitting cross-border marketing to all investors around EU, including retail. Their aim is to increase investment in the real economy by providing financing to infrastructure projects and the SMEs. The possibility of listing ELTIFs enhances investor protection standards but does not solve the inherent hindrance of retail investors to lock capital in longer term assets for risk reasons.

Apart from the availability of secondary trading in a transparent marketplace as a form of exit strategy for retail investors that target ELTIFs, tax incentives for long term holders of listed ELTIFs would increase their appeal to retail investors, would enhance the pool of available liquidity to a wider number of participants, would improve the risk/return profile of such instruments and would eventually maximise the amount of capital available for firms. Such incentives have been in use in several jurisdictions (for example in the UK for SMEs and listed funds), but a harmonised use of those across the EU would benefit the real economy.

[12] Oliver Wyman, "Towards Better Capital Markets Solutions for SME Financing", page 3 and 8.
[13] ESSEC Business Scholl & GE Capital, "The Mighty Middle: Why Europe's Future Rest on its Middle Market Companies"
[14] New Financial, "Capital Markets Union: managing high expectation"

Q4: Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?

1. **Need to re-build local eco-system**

We believe there is a need to re-build the local eco-system (i.e. brokers, auditors, analysts, lawyers, etc.) as was recently noted in a report by the EFC's High Level Expert Group, which called on Member States to *"investigate (and report on) as a matter of urgency what is required in their market to (re)build an ecosystem comprised of dedicated analysts, brokers, market makers, ratings etc., that can both advise and support issuers and investors, and foster the liquidity of equity growth markets. This will aid in the development of small and mid-cap financing through equity growth markets and will also support the private placement mechanism which relies on the same ecosystem".*

Venture capital/private equity and equity/bond private placements are alternatives to listing (or early stage options pre listing). Their relative attractiveness to companies when compared with IPOs – and the ideal sequence of combining them - has changed over time around the world and in Europe. Indeed, the changes made to the regulation of private placements in the US that led to greater liquidity for private placements in the last few decades could explain the trend of companies waiting longer before doing an IPO and the eventual decline of IPOs to some extent.

However, an analysis of trends in the US and in Europe does not support the hypothesis that IPOs are showing a trend of long-term decline simply because of the ample availability of these other sources of capital. On the contrary, IPO markets do need flourishing and healthy venture capital and private equity that will finance and help grow the companies that are too small to enter capital markets. Consequently, the reduction of venture capital in particular leads to fewer IPOs by reducing the venture capital-backed IPOs. At the same time venture capital and private equity do need healthy IPO markets where companies that are ready can enter the 'next level' of financing. The contraction of IPO markets has a negative effect on venture capital and private equity by reducing the possibilities for exits.

Eurostat estimates that the EU 28 still has an unemployment rate of almost 10%, and the euro area well above 11%. With the scope for significant additional public investment constrained in many countries by the size of existing debt and deficit levels it is clear that private investment will have to play a key role in getting Europe back to work. For the bond markets to mirror the success of, for example, the US private placement market, the ecosystem needs to be developed in a meaningful way. Such a development would be particularly important for SMEs as they look for a substitute for bank funding.

European companies need investment, to grow, to enter new markets and to develop new products. A healthy, well-functioning IPO market, and in particular one that attracts both all types of companies and investors to European markets is a critical route to channel such investment.

Furthermore, given that there is a need for enhanced transparency and appropriate disclosure requirements in order to ensure sufficient investor protection in this area, we suggest that this could be achieved by listing these securities on exchanges; a tailored primary markets regime for private

placements would deliver capital access for issuers and would deliver enhanced transparency for investors.

2. The Pan-European Corporate Private Placement Market Guide

FESE wishes to state its support for the guide by the Pan-European Private Placement Joint Committee[1] (PEPP Joint Committee), coordinated by the International Capital Market Association (ICMA), published on 11 February 2015 *the Pan-European Corporate Private Placement Market Guide* (the Guide). The Guide sets out a voluntary framework for common market standards and best practices for the development of a Pan-European Private Placement market aimed at providing medium to long-term finance to European medium-sized companies, in close alignment with the EU's goal of bringing about a Capital Markets Union. We encourage the support of the European Commission and EU Member States in promoting the standards that have now been agreed by the PEPP Joint Committee and set out in the Guide.

- **SECTION 4 – MEASURING TO DEVELOP AND INTEGRATES CAPITAL MARKETS**
  - **SECTION 4.1 – IMPROVING ACCESS TO FINANCE**

Q5: What further measures could help to increase access to funding and channelling of funds to those who need them?

1. Need to develop non-bank funding

FESE believes that capital markets are just as vital as bank financing, as well as considering how disclosure of information could be better calibrated. In particular, FESE considers that sustainable growth and standardisation of corporate bond issuance are vital parts of the CMU development.

The development of non-bank funding is at the core of initiatives to drive economic growth and employment in Europe, given that traditional sources have been decreasing. Investors searching for returns in a long-term low interest rate environment would welcome new investment opportunities. We need to orient more investor flows into listed equity, bond and derivative instruments by avoiding any new or existing tax and regulatory disincentives that suppress investor demand (and, in selective cases, by considering whether to provide potential well-designed tax incentives). Moreover, any new tax policy (including proposals such as the Financial Transaction Tax) which would discourage investors from investing in capital markets, in particular in listed instruments, should be avoided. Setting in place the right regulatory and tax environment will lead to a bigger "demand" side for capital markets.

2. Re-build "Ecosystem" for SMEs

SMEs play a central role in terms of economic activity and employment in Europe. However, the sector's composition and its performance during the crisis varied considerably by geographic location. Non-bank funding has seldom been an option in the past, as SMEs have largely relied on bank loans for funding. Though some existing non-bank funding initiatives are trying to unlock financing for SMEs, the success of these efforts has been limited so far. This is attributable to many factors, including the lack of confidence in discussing alternative funding options coupled with the low level of financial sophistication as discussed above. This makes sense given that 90 per cent of SMEs are actually microenterprises with fewer than ten people. At the same time, SMEs in the countries hit hardest by recession and unemployment struggle the most in terms of access to bank credit, paying significantly higher lending rates than large enterprises.

There is a wide spectrum of initiatives that aim to support SMEs' access to funding in Europe. So far, however, these have mainly come from public institutions and have been aimed at expanding bank lending. Going forward, private-sector, non-bank involvement is crucial, as direct government lending or loan guarantees may result in significant costs to the taxpayer and may even serve to penalise creditworthy SMEs.

In this regard, it is important to consider that many capital market funding options would be further hurt by taxation. A Financial Transaction Tax would increase transaction costs and therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital-raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. The development of the CMU envisages the promotion of

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alternative funding sources in order to facilitate growth. The point is that there is not just one method through which to increase access to funding for SMEs in Europe. Fostering a stable, positive environment and incentivising companies through attractive and diverse funding options is essential.

3. Retail investor participation

Access for different groups of investors, such as retail investors, affects the overall volumes available for investment. While the public markets that are vibrant have very strong institutional investor engagement, they also do benefit from retail investors whose behaviour typically is different (buy-and-hold) and do not need high levels of liquidity. In this regard, the access of European retail investors to EU capital markets shows great diversity, with some markets being very accessible (France, Poland, the UK) while others appear relatively closed to retail investors.

The choice of distribution channels may play a role: retail investors may have the choice to invest directly by themselves via an independent stockbroker or platform, with the assistance of an independent financial adviser or one which may also offer brokerage services, or via a third party distributor, which may either sell its own funds, or those of others. However, while UCITS funds are widely distributed, most of the distribution channels are restricted to those residents in the same Member State, restricting free movement of capital. For example, an online platform such as Fidelity Funds Supermarket offers retail investors direct access to funds and shares, but only for UK residents. There do not appear to be truly pan-European web platforms in this area. This may increase the costs and difficulties for retail investors in accessing information and entering into dialogue with the companies.

4. Make capital markets more accessible to individual investors

FESE supports Better Finance's proposals for making capital markets (listed shares and bonds) more accessible and attractive to individual investors, in particular with regard to the following:

(i) Restore investor confidence and trust in capital markets: much stronger emphasis on EU market abuse and MiFID (best execution, conduct of business rules, misleading information, etc.) rules enforcement.

(ii) This means improving further supervisory effectiveness and convergence, setting up collective redress mechanisms for all EU private investors (private enforcement), improving tracking and sanctioning of market abuses.

(iii) Rehabilitate equity investing (in particular for SMEs) – as the simplest, most effective and liquid long term investment product - and individual share ownership (including employee share ownership), by ensuring a level-playing field for simple securities at the retail point of sale.

(iv) For politicians, policy makers, industry and media to stop confusing "equity markets" with their large cap component only, by referring from now on to broad - "all-tradable" - indices instead of narrow - blue chip - ones, e.g. including small and mid-cap issuers, and not only the big ones.

(v) Eliminate barriers to individual shareholder engagement; in particular ensure free, simple and easy cross-border voting for individual investors, enforce actual voting rights for shareholders in nominee/omnibus accounts, and full rights of association for individual shareholders of any EU domiciled listed company.

5. Support views of Better Finance

We would also wish to note that FESE supports views of the Better Finance as stated in their briefing paper on the CMU. In particular, we support and fully agree that:

- Europe needs to “find ways of linking investors and savers with growth”;
- The cost of capital needs to be lowered, in particular for SMEs:
- “Capital markets need to play a larger role in channelling financing to the economy”;
- Europe needs to “boost the flow of institutional and retail investment into capital markets”.

6. Improve Transparency of European Derivative Markets

As outlined in our ‘Executive Summary’, we believe that derivatives markets play a crucial role in financing the economy. Europe is home to some of the world’s largest and safest on-exchange derivative markets, which enable the risk management for a diverse range of enterprises as well as investors. As the crisis has shown, on-exchange derivatives are very positive for the economy. For many decades, derivatives of various kinds have played a very positive role in the world economy. FESE fully supports any policy initiatives taken to address market deficiencies revealed by the financial crisis which should target improving the safety and integrity of derivatives trading and clearing while maintaining their positive contribution to the economy and the financial sector.

Q6: Should measures be taken to promote greater liquidity in corporate bond markets, such as standardisation? If so, which measures are needed and can these be achieved by the market, or is regulatory action required?

1. Importance of debt financing

In recent years, bond markets in Europe have naturally grown to counter the reduction in traditional funding. Initiatives to incentivise the continuation of this trend would be welcome, particularly for smaller companies for which lower amounts are raised and costs are more critical. For example, uniform bond issuance prospectuses could be developed, as seen in the US. Access to standardised information like this is likely to increase investor appetite and bring about greater liquidity in the bond market, ultimately growing it as a funding source. Another important initiative to increase alternative debt financing might be to enable the free choice of issuance location. Through its initiatives to harmonise differences between Member States, the CMU should look to break down barriers to debt-issuance across borders.

2. Need for increased standardisation

In principle, FESE welcomes standardisation as a way to attract more investors and increase market depth and liquidity. We consider that standardisation of information is of great importance for the development of corporate bond markets throughout EU and more specifically the adoption of a common 'term sheet' containing information on the terms relating to the bond issuance (amount, denomination, interest rate, nominal price, offering price, credit rating, yield to maturity, collaterals, clauses, voting rights etc.). The standardised 'term sheet' will be included in any Prospectus / Offering Memorandum that is published for attracting investors. Regulatory action is required for the adoption of the common 'term sheet’. Bond markets are an important alternative to bank credit. And we

consider them important for infrastructure/project bond investing. However, European bond markets are relatively under-developed and less liquid and less broad than their US counterparts.

In 2011, the volume of the US corporate bond market amounted to 35 percent of GDP, with Japan (17 percent), and the EU average (15 percent) lagging behind. However, if we consider developments between 2005 and 2011, Europe as a whole appears to be catching up. In fact, European bond markets have grown quite extensively since around 2000, in particular in the euro area. Bond market size generally appears relatively robust under the financial market turmoil. While these trends are welcome, EU bond markets must continue to develop further.

3. Understand impact of new rules

Corporate bond markets are being radically changed by a confluence of factors – e.g. new Basel III capital and liquidity rules, the MiFID II requirements on transparency in bond markets, and the availability of innovative new platforms based on equity and FX market technology . Given capital constraints on holding bond inventory, there is a need for a market where liquidity can develop in a transparent, public market rather than only between the dealers.

There has been a debate about European bond markets and the appropriateness of the entire infrastructure, in particular for the trading of European sovereign bonds, and how to improve transparency without adversely affecting liquidity and efficiency. The crisis has shown that transparency is a vital element of well-functioning markets, even and perhaps especially during periods of stress. This has challenged previously existing assumptions about the usefulness of transparency in the bond markets. FESE supports extending transparency requirements to bond markets, with appropriate exemptions and delayed reporting mechanisms. This would solve a number of market imperfections and increase the proportion of market activity that is conducted in a transparent way.

Bond trading is mainly executed on an OTC basis via electronic platforms or via telephone brokerage. It is estimated that about 95% of bond trading is OTC out of which telephone brokerage represents the larger part of the OTC market and only 5% is executed on either RMs or MTFs. Based on our experience, we believe that properly calibrated pre- and post-trade transparency regimes should apply and will benefit all market participants, in particular investors. We therefore welcome the MiFID II regime, an increased transparency regime for bonds under MiFID II will positively reflect in a capital markets union.

Finally, for the bond markets to mirror the success of, for example, the US private placement market, the ecosystem needs to be developed in a meaningful way. Such a development would be particularly important for SMEs as they look for a substitute for bank funding.

Q7: Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?

How IPOs can fulfil and important and social function
In order to be able to fulfil their important economic and social functions and to deliver value to companies and investors as their two key customers, we believe that IPO markets should possess the following characteristics:

- **Communication:** Markets should enable companies and investors to communicate directly with one another, in order to understand one another's expectations and to enable companies to manage their business via resolutions at shareholder general meetings, and in order to ensure that there is sufficient trust and confidence for future capital raising.
- **Resilience:** Ability to remain in business despite changes in economic cycles. Economic cycles will determine both corporate profitability and the availability of equity capital; therefore, a certain degree of contraction will be expected for economic down cycles. However, in our view, an optimally-functioning IPO market would remain in business – i.e., not shut down - even during down cycles.
- **Access:** A key feature of a well-functioning IPO market in our view is for it to be accessible for all companies. A market that is only accessible by large or well-established companies would not be good at fostering innovation and dynamic job growth. It is important to consider differences among quoted companies further, since micro companies below 50 million EUR market capitalisation may have different needs from those at €1 billion market cap.
- **Quality:** A well-functioning IPO market will have high levels of long-term positive performance and minimum levels of bankruptcy, fraud, and value loss. Our vision is not one of a market that produces large numbers of IPOs that soon lose value for their investors, but rather of a market that is reliable, relatively predictable, and trustworthy. This does not mean that there will be only one level of risk and return offered by the IPO market (inevitably, in a risk-taking environment, there will be some failures as well as successes); rather, a healthy equity market will produce a diverse pipeline of IPOs. However, in our view, the majority of firms that list should perform in the long run as investors would reasonably expect them to, based on the information disclosed at the IPO stage, and to continue to generate value in the long run.
- **Depth:** Sufficient depth in terms of the volumes available for investment, the mix of investors, and liquidity. Obviously, the depth of equity markets depends on many extraneous factors, including the size of capital market in general and the balance between equity and debt markets. It is also clear that Emerging Growth Companies' shares will be less liquid than those of the larger companies included in mainstream indices.
- **Fairness:** Finally, the IPO market needs to be open to all investors on equal terms and treat them fairly. A market that only offers good prices to insiders, or which subsidises short-term trading over long-term investment, would in the long run not benefit the economy (and would also not be sustainable). In addition, the market needs to be fair to both companies and investors, as both sides are needed for the market to function.

Currently, the European IPO market is not working for as many companies and investors as it could. There is some way to go before we can say that European IPO markets meet the criteria above and

although Europe continues to build and grow businesses with the potential to be world class, the failure of the IPO market to facilitate companies' access to capital hampers their growth and lowers potential employment.

IPOs are important to the European economy. EU policymakers should consider the role of these markets as part of the broader ecosystem of capital markets, and pay attention to the health of the IPO markets, if we want to provide funding for the Emerging Growth Companies and investment opportunities for the savers of the future. Reforms to regulation, to the tax regime, and to market practices are required to address these structural problems. It is also important to understand that ESG should not be a question of listed vs unlisted but for all companies.

Q8: Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

1. IFRS standards for SMEs will not solve duplication

Introducing a second set of IFRS standards for SMEs will not change the fundamental problem in the EU to produce two sets of accounts. Therefore, FESE would prefer a single set of IFRS for finance and taxation rather than a light version of IFRS for SMEs. However, companies admitted to trading on MTFs must continue to have choice as to whether they use national GAAP or IFRS, and should not be mandated to only comply with IFRS.

Despite efforts to reduce duplication, in practice, European companies still need to produce two sets of accounts:

i. IFRS as the accepted international accounting standard for investor information, which is required to access public markets but increasingly also by banks with increased documentation and rating requirements; and
ii. The national "generally accepted accounting principles" which serve as the basis of taxation and domestic regulatory reporting.

This creates a duplication and, in the case of companies operating in more than one European country, a multiplication of accounting costs and complexity. A possible proposal could be the requirement to impose full IFRS for all SMEs that move from an SME GM to a RM. However, the Commission must note that the cost of moving from local gap to IFRS is greater than having IFRS from the start.

2. Lack of harmonisation of accounting standards

An additional disadvantage is the lack of harmonisation of national accounting rules and taxation base that make it costly for companies to produce a set of national accounting as well as IFRS if they want to access capital markets. For investors, this limits the comparability of companies and makes analysis more complex. There is a need to ensure that the accounting rules for all companies, but especially listed SMEs, remain manageable. An important element would be to ensure that listed companies are not obliged to do double accounting

The lack of harmonisation of taxation and national reporting also complicates financial analysis, since analysts need to familiarise themselves with all the details of national accounting and taxation rules. This is especially a problem for smaller countries since the willingness of investors to research these companies tend to be lower. Therefore, we do not support a 30th regime (i.e. in addition to the existing 28 national regimes and IFRS) for accounting standards.

Q9: Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

FESE would have no objections to the introduction of pan-European standards for peer to peer lending and crowdfunding if deemed necessary and provided that such standards would enhance the safety of these alternative means of financing.

New ways of accessing markets – such as crowdfunding - should be properly regulated to prevent the risk of fraud and scandals, which could further erode public confidence. This must be balanced against the need to encourage new ways of investing. FESE believes that the key to appropriately regulated crowdfunding or peer to peer platforms is to have a calibrated approach that balances both investor protection and public disclosure requirements. We note the current decision of the European Commission not to take legislative action with regard to the gaps in the regulation of crowdfunding identified in the 2013 consultation, and agree with the reasons cited for the wait and-see approach for the moment. At the same time, we believe that the rules applicable to crowdfunding in various Member States should be monitored carefully for signs of any significant divergence, since they could harm the Single Market. Moreover, in the near future, the European Commission should re-visit the option of closing the regulatory gaps regarding crowdfunding in a way that ensures the proper functioning and growth of these platforms to provide a new means of sourcing of finance for companies safely. Insufficient information of investors on the potential of these alternative means of financing and the inability to conduct 'public' transactions on the securities offered by the applicant companies are the main barriers for developing regulated crowdfunding or peer to peer platforms.

With regards to capital raising these markets provide the same type of services as stock exchanges and for this reason they should operate under the same requirements in order to maintain a level playing field for all funding venues.

○ SECTION 4.2 – DEVELOPING AND DIVERSIFYING THE SUPPLY OF FUNDING

Q10: What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

1. Enhance listed funds for SMEs

SMEs and start-ups have, by nature, a smaller market capitalisation that does not allow larger funds and investors to engage directly with them for reasons of efficiency of scale – their "minimum tickets" are too large for an SME. However, the use of a vehicle such as a listed fund with proper governance, target selection and management can attract via a transparent listing process capital from larger investors as the size of commitment from such an investor can be a multiple of the fund's target investments. Therefore, the listed fund can funnel capital into SMEs and start-ups having in its holdings contributions from investors that would not be able to expose themselves to the target investments otherwise. The dispersion of risk from such a fund can also allow retail investors to participate in the IPO; therefore, it taps liquidity to a profile of investors that would avoid exposure to single investments to SMEs or start-ups.

2. Increase the presence of pension funds

Pension fund investments in capital markets need to grow to meet the additional demands put on the system by the aging population and to help finance long-term growth. Pension funds invest in both publicly and privately issued instruments. Globally, 56% of large pension fund assets are in fixed income and cash, 28% are in equity, and 16% are in alternative investments. It is noteworthy that, in some markets, a much smaller share of pension funds are invested in capital markets than the average. In certain countries, pension fund investments have gone down significantly with the crisis (e.g. in the UK). This not only limits the funds available for companies, it also potentially reduces the earnings for pensioners in the long term. Looking at the fixed income share of pension assets, it must be noted that pension funds buy a significant amount of sovereign debt, which crowds out investment in public equity and public corporate debt. Hence, they must be able to invest more in corporate (nonsovereign) debt and equity.

3. Address the bias against investing in equity in Solvency II

As addressed in our response to Question 1, we have concerns about regulatory restrictions of Solvency II in particular. Under the new Solvency II regime insurers must, in principle, hold a 39% capital charge for owning shares in listed companies in the developed markets and a capital charge of 49% for other categories of shares. Depending on the (exceptional) development of share prices, the regulatory authority has the power to adjust this capital requirement upwards or downwards by no more than 10%. A capital charge of 22% applies to participations of a strategic nature. Debt-related instruments are potentially less expensive and they are subject to a capital charge of 15%.

There is no capital charge whatsoever for Treasury bonds issued by Eurozone Member States. Since insurers and possibly regulatory authorities as well are already anticipating the new rules, insurers are in the process of disposing of a significant volume of the equity investments that they hold at their own expense. Some insurers have completely stopped investing in equities, which means that equity funding via the capital markets may not be an option for as many companies, while at the same time

as bank funding may be scaled back. We strongly urge the Commission to prioritise a review of Solvency II in order to remove the bias against equity investments.

Q11: What steps could be taken to reduce the costs to fund managers of setting up and marketing funds across the EU? What barriers are there to funds benefiting from economies of scale?

1. Need to tackle complexity of markets to reduce costs
The broader context of this problem is the greater complexity of markets. As the Kay Review has concluded, the chain of intermediaries standing between investors and their investment has become too long. Greater complexity of markets creates many problems in addition to high proportion of passive investment. Not only does excessive complexity reduce the ability of investors to invest actively or to evaluate the risk they are taking, it also increases the cost of accessing markets. Incidentally, this also makes it more difficult for retail investors (who tend to be active investors) to access the markets directly.

A related point concerns the costs borne by end-users of capital markets, i.e. investors and companies. The EU's Financial Services Action Plan has been built on too narrow a focus on the costs borne by intermediaries. As a result, EU policymakers do not have the tools to measure and assess over time the costs borne by the end-users.

2. Need to increase retail access
A linked question is how retail investors can access markets. Retail investors often complain about their "dis-intermediation" from capital markets and the fact that they are forced to purchase packaged products instead of being able to invest directly in the markets. Currently competition in the execution-only brokerage market in many countries is rather limited; the access to non-domestic securities is often more difficult and expensive and the service face some regulatory constraints in some jurisdictions. Direct market access in Europe still needs to improve further; T2S should be used as a tool to offer all European retail investors access to the entire European security offering in a cost-effective way. Standardisation of products plays an important role in retail investor access.

3. Ensure a level-paying field for shares & bonds versus "packaged" products in "retail" distribution
The key driver for the switch by EU individual investors from direct equity and bond ownership to indirect ownership via "packaged" investment products is the relative profitability of these two investment product categories for the financial industry and distributors: "packaged" products such as investment funds and life insurance. The latter generate much more commission and fees than the former: "retail" entry fees for packaged products are typically much higher than brokerage fees for shares and bonds.

More importantly, the direct ownership of shares and bonds does not generate any of the annual asset based products that can provide benefits for individual investors such as diversification and access to professional investment instruments. Therefore, there must be an end to biased advice at the point of sale together with guaranteed competent advice on long term investments, including equities and bonds; more powers to supervisors to ban "retail" distribution of toxic packaged

investment products but as already mentioned, such products are most often “sold rather than bought”. Therefore, these features are most probably not the main explanatory factor for the switch.

Q12: Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?

FESE has no comment on this issue.

Q13: Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

FESE believes it is important to differentiate between investors: different types of investors have different needs, behave differently and need different protection levels (institutional vs. retail, etc.) For a healthy EU capital markets, ideally one needs, all of these different types of investors.

Investors should be empowered to administrate their private pension plans. To do so, investors must be helped to make better-informed investment decisions. A recent report published by EFAMA and Better Finance highlights[15] the importance of developing partnerships between governments, the financial industry, European institutions and the media in order to promote financial education in an effective manner. The report also confirms the key role that the industry can play in enhancing the quality of financial training of staff and financial intermediaries, such as brokers, advisers, sales people and others. This is viewed as an effective way for investment managers, who are not in regular contact with end-investors, to contribute to improved investor education.

Also, the long-term changes that might have led to more of a trading- and speculation-based market are usually seen as the reason why investors are less willing to invest long-term and less willing to invest in companies, as the need to analyse the risks (as opposed to indexing).

Q14: Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund managers to run these types of funds? What other changes if any should be made to increase the number of these types of fund?

FESE has no comment on this issue.

[15] http://www.efama.org/Pages/EFAMA-Investor-Education-Report-Uncovers-Widespread-Financial-Illiteracy-across-Europe.aspx

Q15: How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

EU could support the idea of having PE & VC funds listed in public markets (Regulated Markets & MTFs), thus providing them the possibility of a further fund raising from the wider investment community. Support may be expressed through the adoption of tax incentives for investors. By definition, listing on a Regulated Market or MTF enhances exit opportunities for venture capital investors. This issue is also covered in our response to Question 1 and the funding escalator.

Q16: Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

FESE has no comment on this issue.

Q17: How can cross border retail participation in UCITS be increased?

FESE has no comment on this issue.

Q18: How can the ESAs further contribute to ensuring consumer and investor protection?

The ESAs should ensure a consistent and harmonised implementation of measures that would enhance investor's protection. An example of such consistent application could be the provision of execution only services are implemented and supervised.

Q19: What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

1. Need to avoid complexity and promote direct investment

To help increase active investment, and to improve investor access, we need a streamlined and simplified process for corporate governance, in which intermediaries inform investors adequately and enable them to participate in decision-making in companies. We should avoid unnecessary complexity when meeting investor needs. This not only means reducing the complexity of the intermediation chain, but also avoiding unnecessary complexity in trading. The US, which has a market structure that is generally accepted as being too complex, is on a path to review its structure to reduce this complexity.

We believe that retail investors should not only be able to invest in managed funds but also be allowed to have a more direct access to the markets, with nonetheless the need for an equilibrium between

the participation of retail and institutional investors considering the 'stabilising' role of the latter on the markets. Hence, we believe Europe needs to keep the markets for e-brokerage open and to ensure access to all European securities. With the greater computerisation of the households, e-brokerage creates opportunities by adding to the diversity of methods for investing. In parallel, all Europeans should have access to all publicly traded securities in a cost-effective way.

Retail investors could also have access to the primary bond markets (they are only active in the secondary bond markets today, which is due to the distribution channels). However, this has to be weighed against the greater risks for retail investors, since bonds are more heterogeneous, and there is a downside to retail investor participation in these markets.

More generally, efforts to increase greater direct retail participation have to be balanced against the need of investor protection. While we call for greater possibilities for retail investors to access capital markets directly, we recommend caution against exposing retail investors to risks which they are not well-placed to assess. Markets must facilitate access for investors. As noted, the FSAP has focused too much on trading costs borne by intermediaries. In our view, the full front-to-back cost chain must be taken into account (from intermediation costs to settlement) as well as implicit costs (market quality metrics such as execution price, spread and market depth) demonstrating that open, multilateral markets overall have a better market quality, and hence lower implicit costs.

The choice of distribution channels may play a role: retail investors may have the choice to invest directly by themselves via an independent stockbroker or platform, either on an execution only basis or with the advice or assistance of a broker or an independent financial adviser. Alternatively they may invest via a third party distributor, which may either sell its own funds, or those of others. However, while UCITS funds are widely distributed, most of the distribution channels are restricted to those residing in the same Member State, restricting free movement of capital. There do not appear to be any truly pan-European web platforms in this area. This may increase the costs and difficulties for retail investors in accessing information and entering into dialogue with the companies.

2. Need for tax incentives

EU citizens as individual investors need positive incentives ("carrots"), and not "sticks", to channel savings into long term investments for the real economy. Currently, they are suffering from excessively high financial fees from financial institutions which too often destroy the real value of their savings.

In particular, tax incentives for direct equity investments (e.g. share savings plans) would support further growth, especially if channelled to growth companies and connected to a long-term holding period. We point, for example, to the UK Finance Act 2013 and its consequences for the Alternative Investment Market (AIM) which enables individual investors to invest in AIM companies through their Individual Savings Accounts (ISAs). ISAs are tax efficient as an individual pays no tax on the income received from ISA savings and investments or capital gains up to an annual limit of GBP 15,000 (for 2015). In addition, further tax exemptions (e.g. stamp duty) apply to investments in growth companies as well. Another example is the French PEA ("Plan d'Epargne en Actions" or Equity Savings Plan) which exempts individual investors from income and capital gains taxes if they hold their equity (or equity funds) investments for more than eight years. We are aware that tax incentives should not be considered as the principal reason for investment. However they can enhance financial returns if the

tax incentives are not captured by the providers in higher fees and commissions. And there should be no tax bias in favour of short term investments over equity.

Q20: Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

FESE has no comment on this issue.

Q21: Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

In the coming legislative period, efforts should focus on clarifying the basis on which access to the European market is to be provided. We need to remain open to the outside world, but ensure that this access satisfies the major policy objectives we have for our citizens and economies. The current TTIP negotiations – if they result in the inclusion of financial services - should be seen in this context. Specifically, the terms on which access is provided need to ensure adequate protection for European investors, proper supervision by European supervisors, fair competition and level playing field among all institutions, as well as building on the principle of trust in the mutually shared principles of other jurisdictions.

In terms of promoting the EU "regulatory model," we believe Europe needs to be more active especially in the developing world. There are various regional integration projects for which the EU model could be relevant, as well as single jurisdictional reforms to which the EU model contribute.

Q22: What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?

We believe that the EU must remain open to 3rd countries' investors, issuers, and financial institutions, while ensuring adequate protection for European investors, proper supervision by European supervisors, and fair competition based on a level playing field among all institutions. The European capital markets are governed by the principle of trust in the mutually shared principles of other jurisdictions. We believe that Europe must make further progress in this area: the framework for access by 3rd country participants is currently not complete. Some aspects have been covered by MiFID II, but there are also gaps (e.g. regarding the conditions of access for market operators).

It is a fact that several jurisdictions – e.g. from Africa or Asia – have looked at the EU model as an inspiring model of regional integration for their capital markets. While avoiding extraterritoriality, Europeans should continue to promote the European regulatory model as best practice around the world whenever appropriate. Hence, Europe needs to assert its principles and values more independently of other jurisdictions (while actively shaping international standards).

We recommend that in the coming legislative period, efforts should focus on clarifying the basis on which access to the European market is to be provided. We need to remain open to the outside world, but ensure that this access satisfies the major policy objectives we have for our citizens and economies. The current TTIP negotiations – if they result in the inclusion of financial services - should be seen in this context.

Furthermore, regulators should remove barriers in IPO and SPO participation for 3rd countries' investors by introducing measures such as the possibility of Prospectus 'passporting' by 3rd countries' competent authorities and the harmonisation of the listing procedure in terms of timing, actions and information available to the public. This is being addressed in greater detail in the FESE response to the consultation on the Prospectus Directive.

FEDERATION OF EUROPEAN SECURITIES EXCHANGES

SECTION 4.3 - IMPROVING MARKET EFFECTIVENESS – INTERMEDIARIES, INFRASTRUCTURES AND THE BROADER LEGAL FRAMEWORK

Q23: Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

1. Treatment of equity vs debt
From a company/issuer perspective, equity is more heavily taxed than debt in most countries, which disincentives equity investment. Interest payments on debt may be deducted from profits before they are taxed, whereas equity financing does not receive any form of tax relief (and indeed is subject to significant taxation both in terms of capital gains and dividend payments). This structural bias towards debt financing encourages companies to take on debt rather than equity; yet high debt-to-equity ratios increase the likelihood of bankruptcy and encourage risk-taking, often at the expense of creditors and governments (rather than shareholders).

Rebalancing the current bias towards debt financing could be an important initiative for the CMU for two reasons. Firstly, it may encourage companies to strengthen their equity base and discourage levels of leverage that are too high, thereby improving their financial stability via increased loss absorption capacity. Secondly, it may result in investors paying lower taxes on their equity investments, incentivising provision of equity capital as an alternative funding source.

There is also wide variation in the gap between effective marginal tax rates on debt and equity-financed investments. According to the International Monetary Fund, this gap ranges from 10 to 50 per cent for European countries. Therefore, it is not only important to rebalance this bias, but also to harmonise tax procedures within Europe, in order to create a level playing field. An additional point to consider is that this bias is even more pronounced in the US than it is (on average) in Europe. As a result, rebalancing the bias across Europe in the form of a reduction in the tax on equity investments might serve to increase the attractiveness of investing in the region.

2. European Derivative Markets
Derivative markets play a crucial role in financing the economy. Europe is home to some of the world's largest and safest on exchange derivative markets, which enable the risk management for a diverse range of enterprises as well as investors. As the crisis has shown, on-exchange derivatives are very positive for the economy. For many decades, derivatives of various kinds have played a very positive role in the world economy. FESE fully supports any policy initiatives taken to address market deficiencies unveiled by the financial crisis which should target improving the safety and integrity of derivatives trading and clearing while maintaining their positive contribution to the economy and the financial sector.

FESE members play an important role in the global derivatives market. They operate well-regulated, transparent, technologically advanced trading (and in some cases clearing) arrangements with a proven value proposition and track record in safety and reliability. It is the wish of derivatives exchanges to maintain the highest standards of safety and integrity, as well as efficiency and competitiveness, in the trading of derivatives in a global marketplace. Regulated markets ensure that

all derivatives trades are cleared through central counterparties. As was the case for fixed income, the crisis has shown that transparency is a vital element of well-functioning derivative markets, even and perhaps especially during periods of stress. On-exchange trading has been proven to perform in extreme conditions like the recent financial turmoil, when the Lehman Brothers' outstanding positions where closed out within hours. Trading via regulated exchanges cleared into central counterparties mitigate counterparty risk, increase liquidity, allow for sound margining and risk control requirements over clearing house members, increase transparency on open risk positions and provide records on OTC derivative transactions. In addition they offer greater risk reduction benefits, particularly in terms of increased liquidity in moments of stress in OTC markets.

Hence, OTC derivatives have been put on a path of standardisation and clearing to ensure that derivative markets as a whole pay a positive role. In this sense, the size of derivative markets in Europe is generally satisfactory when measured against the needs of the economy, but the share of on-exchange vs OTC should (and will) increase as a result of the policy changes in motion.

Q24: In your view, are there areas where the single rulebook remains insufficiently developed?

In principle, FESE supports the trend from Directives to Regulation. This could enable ESMA to take a greater role in regulatory convergence.

Q25: Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?

We believe that the Capital Markets Union has to build on the basis of an efficient supervisory structure; as such, the **subsidiarity principle** with national competent authorities having primary responsibility should be kept and redundancies avoided. If European supervisory structures are introduced, **clear responsibilities, rules for decision making and procedures** are needed in order to allow for **efficient processes** with regard to market participants, as time matters. Moreover, the CMU must bring about more consistency and further harmonisation.

The principle of subsidiarity aims at determining the level of intervention that is most relevant in the competency areas shared between the EU and the Member States. This may involve action at the European, national or local level, but the EU may only intervene if it is able to act more effectively than the Member States. We strongly believe that the powers of the ESAs to ensure consistent supervision are sufficient enough. We propose that a survey should take place on a regular basis to verify the adoption and consistent implementation of EU's regulatory standards among Member States.

With regard to the reality of European financial supervision, the picture is twofold. On the one hand, each of the 28 Member States has its own national government, regulator and supervisory authorities that best know the local market. Whether it is necessary or desirable to transfer the power to

supervise capital markets from national authorities to European institutions is an important consideration. Transferring national sovereignty to the supranational European level would be a major change and would require the acceptance of national policymakers and voters.

On the other hand, the Banking Union – 120 banks under the direct supervision of the ECB – has integrated and transferred supervisory powers to the ECB. The key rationale behind the move was to allow cross-border comparisons and to help identify risks at an earlier stage. Furthermore, the danger that national supervisors could be home-biased in their treatment of national entities is mitigated.

The European Securities and Markets Authority (ESMA) was established for capital markets, allowing national authorities to take decisions in the ESMA Board; in its current state, it is a combination of both national and European supervision. European financial market infrastructures are currently supervised differently: exchanges and CSDs by national supervisory authorities; CCPs by national supervision in combination with supervisory colleges; trade repositories by ESMA.

Q26: Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?

The views stated below are based on the response from ECSDA

FESE supports the adoption of a legislative proposal further harmonising securities laws, including rules related to securities ownership, as part of the Capital Markets Union 2019 Action Plan, provided that the following conditions are met:

(i) The legislative proposal should focus on a few specific aspects of securities law and should not attempt to achieve widespread harmonisation of material aspects of securities law, which is likely to prove extremely complex. Embarking on a more ambitious harmonisation effort of current national regimes in order to address the substantial issue of “who owns what”, would first require a comprehensive assessment of the benefits and disadvantages of all the current regimes in Europe. **Meaningful harmonisation can be achieved by implementing the book-entry principle across the EU**, in order to reduce obstacles and legal uncertainties around cross-border holdings and transfers of securities. This would include making acquisitions and dispositions of securities effective by crediting, debiting or earmarking of a securities account and the implementation of a general “no credit without debit” principle (however recognising that there are certain cases where such a principle is impractical).

(ii) Moreover, the proposal should introduce **harmonised conflicts-of-law rules** applicable to all aspects of holding, acquisition and disposition of securities following the PRIMA principle, already adopted by the Settlement Finality Directive (SFD) and the Financial Collateral Directive (FCD). Currently, harmonised rules on the ownership of securities are included in the FCD as well as in the SFD, but in both cases they are limited in their scope. While art.8 of the SFD applies to insolvency proceedings only, art.9(2) of the SFD and art.9 of the FCD are restricted to collateral transactions. Extending these rules to cover all proprietary aspects of securities holdings would strengthen legal certainty for cross-border securities transactions. In line with the T2S AG response to this consultation, ECSDA believes that such rule should follow the PRIMA

principle. In other words, the applicable law to securities accounts at the CSD should be the one of the country where the CSD is legally established.

(iii) Third, such EU legislation should retain a broadly **functional and horizontal approach.** Its primary objective should be to increase transparency and enhance legal certainty of collateral holdings throughout the entire securities holding chain. As a "horizontal" legislation, it should moreover aim to complement the different pieces of sectorial legislation already adopted (MiFID, EMIR, CSDR etc.) in order to avoid overlaps and inconsistencies.

(iv) **In particular, it should specify the role and responsibilities of account providers and introduce a consistent framework of rules on the segregation of client securities accounts applicable to all account providers (including CSDs)**. The current fragmented approach includes different rules on account segregation spread over many pieces of legislation (EMIR, MiFID, BRRD, CSDR etc.) and there does not seem to be a clear vision in terms of the right "level" in the chain where segregation should be encouraged to ensure maximum investor protection. A more consistent and truly harmonised approach on this important issue would benefit investor and issuer transparency, while clarifying the rules to which intermediaries and infrastructures are subject to in relation to account and asset segregation.

Q27: What measures could be taken to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

A further harmonisation of securities law through EU legislation covering the aspects mentioned in our response to question 26 could significantly strengthen legal certainty in relation to cross-border securities holdings and would therefore also improve the cross-border flow of collateral.

Q28: What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?

While companies accept that some corporate governance rules may help to attract investors, they may fear that others will undermine their ability to run their company. For example, the recent proposal for a directive on shareholder rights contains very wide-ranging new powers for shareholders on related party transactions. These are widely perceived by companies and their legal advisers[16] to have a likely impact on day to day operations. While some oversight may be advisable, the extent of such proposals may also be a disincentive to listing, if the existing owners and management feel that the company will be hampered in its decision-making by going public. An effort should be made to reduce the impacts that increase the regulatory burden brought about by the EU shareholder rights directive proposal on addressing remuneration and related party transactions at Annual General Meeting at EU level and, if necessary, on national implementation.

[16] Linklaters LLP, "European related party transaction rules: the impact on on listed companies"

We support recommendations of the IPO Task Force for certain exemptions from the provisions of the EU Shareholder Rights Directive and recent EU Audit Regulation and Directive. FESE would also like to highlight that the lack of harmonisation of taxation and national reporting also complicates financial analysis, since analysts need to familiarise themselves with all the details of national accounting and taxation rules. This is especially a problem for smaller countries since the willingness of investors to research these companies tends to be much less.

However, in relation to corporate governance codes, we do not see the same need for full harmonisation. Although there are differences in the specific requirements in corporate governance codes across Member States, we are of the view that the principles are broadly aligned and seek to address similar regulatory objectives. We fully support the code based approach which works very well in practice and, in our view, corporate governance regimes would be less effective if they moved to a legislative base. We believe that the recent Recommendation from the European Commission is sufficient intervention in this area.

Q29: What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

The views stated below are based on the response from ECSDA

FESE agrees with the Commission that substantial divergences among national insolvency laws and procedures may create legal uncertainty and can be a barrier for cross-border securities investments. From a CSD's perspective, significant differences or incompatibilities in formal insolvency proceedings have negative repercussions on cross-border securities operations. We therefore support the assessment in the Green Paper (p.25) that "reducing these divergences could contribute to the emergence of pan-European equity and debt markets, by reducing uncertainty for investors needing to assess the risks in several Member States."

A substantial harmonisation of insolvency procedures through EU law is probably unrealistic given that this area of law remains primarily a national competence. However, FESE believes that there is some room for action to gradually reduce divergences. For instance, we welcome the ongoing work in the context of T2S as regards the treatment of pending (cross-border) settlement instructions in the case of insolvency. FESE also agrees with the response of the T2S AG to this consultation as regards the need for the European Commission to address certain existing divergences in the transposition into national law of the relevant EU laws in the field of insolvency procedures (SFD, FCD, and Winding-up Directive).

FEDERATION OF EUROPEAN SECURITIES EXCHANGES

Q30: What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

1. Equity vs Debt

From a company/issuer perspective, equity is more heavily taxed than debt in most countries, which disincentives equity investment. Interest payments on debt may be deducted from profits before they are taxed, whereas equity financing does not receive any form of tax relief (and indeed is subject to significant taxation both in terms of capital gains and dividend payments). This structural bias towards debt financing encourages companies to take on debt rather than equity; yet high debt-to-equity ratios increase the likelihood of bankruptcy and encourage risk-taking, often at the expense of creditors and governments (rather than shareholders).

Rebalancing the current bias towards debt financing could be an important initiative for the Capital Markets Union for two reasons. Firstly, it may encourage companies to strengthen their equity base and dis-courage levels of leverage that are too high, thereby improving their financial stability via increased loss absorption capacity. Secondly, it may result in investors paying lower taxes on their equity investments, incentivising provision of equity capital as an alternative funding source. [Please refer to our response to Q6 for more details].

There is also wide variation in the gap between effective marginal tax rates on debt and equity-financed investments. According to the International Monetary Fund, this gap ranges from 10 to 50 per cent for European countries. Therefore, it is not only important to rebalance this bias, but also to harmonise tax procedures within Europe, in order to create a level playing field. An additional point to consider is that this bias is even more pronounced in the US than it is (on average) in Europe. As a result, rebalancing the bias across Europe in the form of a reduction in the tax on equity investments might serve to increase the attractiveness of investing in the region.

2. Consequences of an FTT

A financial transaction tax would increase transaction costs and would therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital-raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. We consider that the introduction of an FTT in 11 Member States contradicts harmonisation of tax rules. In this regard, it is important to consider that many capital market funding options would be eligible for taxation.

Q31: How can the EU best support the development by the market of new technologies and business models, to the benefit of integrated and efficient capital markets?

The ability to issue share options (not only to management but also to all employees) is a significant tool for companies to reward employees and to ensure that their incentives are aligned to the growth of the company[17]. This is vital for "new economy" companies in the high tech, med tech sectors who

[17] Inter-University Centre for the EC's DG MARKT, "The Promotion of Employee Ownership and Participation",

are increasingly important for the EU capital markets. These companies must compete for increasingly scarce talent, often against a US incentivisation model. The tax treatment of share options in Europe varies amongst Member States. In many, share options are taxed against the employee upon issue, rendering them very unattractive and not a valued incentive as they have to fund an incentive not yet realised in financial terms.

The European Federation of Employee Share Ownership (EFES)[18] has reported that, for the third consecutive year in 2014, the number of employee shareholders decreased in Europe; the overall decrease was c. 300.000, of which the numbers in continental Europe decreased by 500.000 persons (-8%) from 2007 to 2014, while they increased by 200.000 persons in the UK (+8%). EFES considers that "these changes are clearly related to the regressive fiscal policies in many European countries, while in contrast, the UK chose to double the fiscal incentives for employee share ownership, considering it is a key element of recovery and an investment for the future". We believe that fiscal incentives to increase employee shareholdings would be an important source of financing for these companies.

Technology is a true game changer for the entire financial industry (e.g. digitalisation, use of electronic systems, etc.) – anywhere in the world. The securities and derivatives markets have experienced the disruptive and innovative force of technology already twenty years ago. More and more other financial segments get first-hand experience of how technology is able to completely overhaul existing business models. But technology is not only a driver of change; technology is also an essential means to guarantee an orderly functioning of financial markets. A reliable and trustworthy financial environment is required for raising capital, for the transfer of risk and to foster international trade. Technology is able to support this in various ways, most prominently through creating transparency and through providing "level playing fields" for market participants.

In order to support the evolution of integrated and efficient capital markets, these qualities - transparency and fairness - should be encouraged and promoted also from the regulatory and political view. The EU should therefore allow the market to develop new technologies and should not intervene by hindering the use technological developments/progress.

Q32: Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

1. Market structure and market data

FESE questions why the issue of Consolidated Tapes is included in the concept of the CMU. The consolidated tape will be introduced by MiFID II. Article 90.2 even includes a review clause on the effectiveness of the CTP regime. In case no consolidated data / Consolidated Tape – in the form as required by legislation now – is made available, MIFID II already foresees a public procurement process for the appointment of a commercial operating entity. Additionally, as of today, MIFID II foresees that data is being made available at reasonable commercial terms. To avoid double regulation we recommend dismissing this element within the CMU Green Paper.

[18] Mathieu M., European Federation of Employee Share Ownership (2015), "Annual Economic Survey of Employee Ownership in European Countries"

While the issue of real-time Consolidated Tapes to the public is being taken care of already by MIFID II (as described above) ESMA and the NCAs seem to be in a position where they receive and will continue to receive vast amounts of T+1 data (e.g. position reporting data, transaction reporting data, including vast amounts of non-publicly available personal data) which currently they cannot use in an efficient and sensible way. Please note that we talk about different as well as broader sets of data with a significant time difference in this context compared to the Consolidated Tapes as referred to above.

For T+1 transaction data as well as respective reference data ESMA has just launched “centralized data projects” for MIFID and EMIR. To our knowledge those projects shall result in a central database for regulators, for the first time allowing common access and information sharing as well as information extraction. In this context it will be necessary, however, to consider both data protection rights of reporting parties as well as potential IP rights as regards the collected reference data which finally will also be published on the ESMA web-site.

2. Securitisation

While FESE has not responded to the Commission’s specific consultation on Securitisation, we do support this initiative and believe the emphasis on the need to encourage high quality securitisations and free up bank balance sheets to encourage lending provides a number of significant opportunities. We consider both direct and indirect ways of accessing capital markets are important to supplement banking finance.

One particular point we would like to highlight relates to the oversight of qualifying instruments. We consider an independent body is best suited to ensuring that criteria for qualifying instruments are met and would suggest the Prime Collateral Securities (PCS) label is a perfect example of how such a system could work. The qualification criteria are set by an independent body, in consultation with industry practitioners (which could work as a template for any EU criteria). Assessment of the criteria can be carried out by the independent body, which is established on a not for profit basis. All criteria and the assessment of how an instrument meets these should be made publicly available so as to ensure optimum levels of transparency. We believe this will be an important part of the framework for developing a high-quality securitisation market.