

# FESE Blueprint

**CAPITAL MARKETS  
UNION BY 2024  
A VISION FOR EUROPE**



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## ABOUT FESE

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.

At the end of 2018, FESE members had **8,660 companies listed on their markets**, of which 13% 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 capital markets; 1,323 companies were listed in these specialised markets/segments in equity, increasing choice for investors and issuers. Through their Regulated Market (RM) and Multilateral Trading Facility (MTF) operations, **FESE members are keen to support the European Commission's objective of creating a Capital Markets Union.**

**Disclaimer** The FESE Blueprint "Capital Markets Union by 2024" (the "Blueprint") is intended for general information only.

## FOREWORD

Petr Kobic, FESE President



The Capital Markets Union (CMU) was conceived in 2014 to boost trust and confidence in EU capital markets by deepening and further integrating capital markets and providing new sources of funding for businesses. The FESE Blueprint: “Capital Markets Union by 2024”, comes at the time of the European Parliament elections and ongoing Brexit negotiations. It addresses specific policy areas which need to be tackled to ensure the goal of unlocking funding via European public capital markets to the benefit of all stakeholders and society at large.

In this report, FESE Members have put together a series of 20 Principles and Policy Recommendations to support European policymakers in their reflections on a CMU visionary agenda for the new mandate beginning in Q4 2019. It builds on the previous FESE publication “FESE Blueprint for European Capital Markets: How to unleash market’s potential to finance dynamic and sustainable growth” (2014)<sup>1</sup> and the report on “Strengthening Europe’s position in global capital markets”<sup>2</sup> (2017).

Securing the right market structure for European public capital markets will continue to deliver price formation thereby serving companies and investors. This Blueprint includes concrete steps towards serving this objective. Moreover, it emphasises the measures required to support the derivatives industry which is crucial to Europe’s capital markets. It sets out a series of pragmatic ideas and proposals for a reform of the equivalence regimes as an important factor in underpinning the EU’s global competitiveness.

If reviewed and implemented successfully, a revamped CMU has the potential to stimulate growth and innovation through increased financing opportunities for businesses and investors, enabling Europe to compete more efficiently on a global level and deliver positive benefits for European citizens. Policy makers in partnership with the industry must re-double their efforts and take bold decisive steps with tangible objectives that will ensure the EU is attractive to global capital and companies, whilst maintaining transparency, integrity and investor protection.

As a convinced European, I have no doubt of the positive effects of the EU Single Market and the CMU project. I am proud to say that FESE Members fully support the CMU’s goal to unlock funding in support of growth in Europe. Accessing funds through capital markets will undoubtedly achieve higher levels of economic growth, innovation, risk management, savings mobilisation, wealth distribution and job creation providing we achieve the right balance.

On behalf of the FESE Members, I look forward to engaging with EU policymakers and stakeholders to achieve these objectives and bring Europe to the next level.

Petr Kobic,  
FESE President

## EXECUTIVE SUMMARY

In the context of the global challenges that the European Union (EU) is facing, it is crucial that we take a step back and **reflect on how the EU can foster a deeper and more integrated financial system** which will be beneficial to the real economy while continuing to be open to global capital markets.

Within the EU, Brexit will undoubtedly have an impact on established capital market ecosystems with consequent implications for capital flows and liquidity. Globally, the US will most likely pursue its (de) regulatory reform agenda in ways which may prove attractive to European companies and investors. Asia can also be expected to continue its focus on growing its own market infrastructures and capital markets. In a world in which multilateral cooperation is being threatened, we need to be mindful of the social value of capital markets as a means for transparent asset valuation and capital allocation, participation of citizens in the productive capital for their long-term investments, oversight of companies through sound corporate governance and last but not least sustainable growth of wealth and employment.

As a starting point, the EU should **strive to maintain globally competitive European capital markets**. Regulation needs to remain aligned with global standards, particularly for derivatives, as international coherence is important to avoid regulatory arbitrage, allow a level playing field when competing on a global scale and most importantly: support economic growth in Europe.

Whilst the political landscape has changed significantly since its inception, **the Capital Markets Union (CMU), from an Exchanges' perspective, is key towards mobilising and strengthening EU public capital markets**. In particular, all policies should be geared towards benefitting European companies wishing to raise capital and investors seeking sustainable returns, combining to support growth in the real economy.

A more integrated capital market will allow better access to securities markets, with investors facing fewer barriers when investing in other EU countries.

EU households will be able to increase the returns on their savings with a greater choice of assets to invest in. As a result, Europe will increase its average potential growth performance and capital will be directed more easily towards the more productive and innovative investments across the EU. Improved integration and development of capital markets will valuably complement Banking Union, as they both facilitate economic adjustment and contribute to increasing economic resilience. **The European Parliament Research Service (EPRS) estimates that the potential benefits from more fully integrated and more effectively regulated EU capital markets could be in the order of €137 billion per year<sup>3</sup>.**

Strengthening the public capital markets offering is key. Whilst the CMU aims at making companies less dependent on bank finance, capital markets in Europe still present a bias towards debt financing, show greater liquidity fragmentation and less transparency than its counterparts in America and Asia. The capital markets structure in Europe needs additional enforcement to strengthen the transparency that is required for effective price formation. Ensuring a level playing field through fair and transparent competition is crucial.

While the EU's goal to create a Single Market through greater competitiveness was fully endorsed by Exchanges, and whilst the Markets in Financial Instruments Directive (MiFID) framework delivered greater choice and lower trading fees, the focus was on the largest and most liquid stocks i.e. the blue chips, without consideration of the impact these rules would have on the listing conditions faced by Small and Medium Sized Enterprises (SMEs). **Pan-European trading led to a greater concentration of activities covering blue-chips, whilst adversely shifting trade and investment away from smaller companies**. One of the adverse effects of this is that the number of initial public offerings (IPOs) in Europe has fallen (and is still diminishing) and subsequently impacting on EU economic growth.

Why is this happening? The reasons are manifold, and it will take a holistic, coherent and well-coordinated policy effort in the CMU. **Current regimes of insolvency, intellectual property rights, accounting and taxation are insufficient** in the context of global competition and seem to be unfortunately discouraging companies from listing in Europe. Regulatory overhead and compliance cost for SMEs and brokers catering to SMEs need to be reviewed. Local and European ecosystems need to be strengthened. Investment in SMEs and equity in general need to be incentivised. **CMU needs to deliver a holistic equity ecosystem allowing companies to successfully scale up** and grow in Europe with attractive financing conditions as well as providing solid investment opportunities to investors.

When assessing the impact of MiFID - we observe a **growth in dark trading**; consequently, weakening the basis of price formation and the very basis of the equity ecosystem in Europe. **Policy makers must reflect on the most appropriate market structure enforcement, to allow a robust price discovery mechanism.** A liquid and transparent pool which forms prices is key for the well-functioning of capital markets and to deliver for end-investors. Exchanges provide reference prices to all market participants including those that do not contribute to the price formation process. In the absence of policy action, price formation on public markets may become non-viable in the long-term, leading to the re-emergence of dealer markets with higher risk to systemic stability, higher cost and less transparency. Investor confidence must remain a key priority of the next regulatory plan and to achieve that, investors should be reassured that capital markets are open, well-regulated, transparent, and fair.

In derivatives trading, Europe is home to some of the world's largest and safest markets in Exchange Traded Derivatives (ETDs). These markets operate well regulated, transparent, technologically advanced trading and clearing arrangements with a proven value proposition and track record in safety and reliability. Capital markets regulation pertaining to ETDs needs to

remain aligned with global standards as international coherence is important to avoid regulatory arbitrage and encourages global capital flows that support economic growth in Europe while maintaining financial stability.

Whilst recognising specific regulatory changes is an important element of CMU, in parallel, **the CMU should also focus on technological evolutions and sustainable finance**, which are essential to deliver sustainable long-term investment returns.

Technological evolutions are likely to produce transformational changes across the entire capital markets' value chain. Regulation will no doubt impact the distribution of incentives among capital market ecosystems, notably in respect of disintermediation. While technological developments should be embraced, it is also important to ensure a level playing field and to safeguard investors' protection.

Given the urgent threat posed by climate change, capital markets have a crucial role to play in financing a future sustainable economy. Exchanges fully support the commitment by EU policy makers to find collective solutions to this global issue and are keen to include this important issue in the CMU. Ultimately only sustainable enterprises can deliver sustainable returns.

**Legislation should move towards even more market orientation.** Europe's capital markets will be best served if policymakers continue to identify areas where further harmonisation can remove unnecessary barriers to cross-border investments within Europe. Guaranteeing a coherent regulatory framework that enables the political objectives to deliver on the economy is vital. This Blueprint provides a solid basis in achieving these objectives.

# KEY CONTENT

In this Blueprint, **FESE sets out 20 Principles and Policy Recommendations as a contribution** to the mandate of the next European Commission to take CMU forward, in conjunction with the co-legislators in the European Parliament and Council and alongside industry. While some of these Principles and Recommendations were included in FESE's first CMU Blueprint in 2014, they have been updated to reflect developments since then as well as Exchanges' ambitions for the next legislative cycle.

They are grouped under seven main themes:

1. Overall Ambition and Approach (Principles 1-5)
2. Funding the Economy: Serving Investors and Companies (Principles 6-9)
3. Fair and Orderly Equity Market Structure (Principles 10-13)
4. Efficient Risk Management – Exchange Traded Derivatives (ETDs) (Principles 14-16)
5. New Technologies (Principle 17)
6. Sustainable Finance (Principle 18)
7. Pursuit of Global Competitiveness and Access (Principles 19-20)

## The EU should strive to maintain globally competitive European capital markets

- Capital markets regulation needs to remain aligned with global standards, particularly for derivatives, as international coherence is important to avoid regulatory arbitrage and encourages global capital flows that support economic growth in Europe;
- The European Commission should use the start of its next mandate to reflect on the overall ambition and approach to CMU with the objective of ensuring that CMU is framed around a holistic regulatory agenda. Including and embedding legislation would be an important step forward in terms of delivering coherent policy outcomes;
- While proposals have been made under the CMU to address the tax-bias against equity financing in favour of debt-based models, it is imperative that

this work be completed under the next mandate. In addition, policymakers should also consider carefully the implications of European level transaction taxes given the potential they have to harm liquidity and thus work against the objective of strengthening EU public capital markets.

## A core focus of the CMU should be on funding the economy, with initiatives developed to increase issuer and investor use of public capital markets

- Fostering financial literacy among both investors and companies is a fundamental pre-requisite of successful and inclusive public capital markets. While this is a broad challenge, it is a necessary objective;
- Increasing the levels of retail and institutional participation is paramount, by unlocking funding and allowing it to flow from Europe's savers to its businesses. Limitations on the ability of retail savers to make direct investments in shares and bonds significantly reduce the value of the proposal. Turning to the institutional side, while progress has been made under CMU to address the capital charge bias against equity investments by insurers under Solvency II, this needs to be fully delivered on under CMU in the next political mandate;
- The drive for greater market integration and cross-border activity should be accompanied by a parallel focus on strengthening local market ecosystems across the EU. Maintaining a diverse and dynamic mix of ecosystems within the Single Market is all the more pressing given the implications arising from Brexit and the loss of the City of London as the EU's financial centre.

## These recommendations should be underpinned by fair and orderly equity market structures in the EU

- Policymakers should continue to strive to increase the proportions of equity trading taking place on transparent trading venues given its fundamental importance to the price formation process in the economy;
- Public capital markets rely on liquidity provision by a range of market participants and different flows.

Among these, a central liquidity role is fulfilled by market makers. It is important that the role and function of these players is properly understood and reflected within the legislative framework. In the short-term, it is important that the finalisation of the revised capital requirements framework for investment firms (IFD/IFR) reflects the nature of these firms in the allocation of the requirements to them;

- Market data costs should be viewed in a holistic fashion by assessing the entire market data value chain – and each of the categories of market participants therein. The value of the price formation process and the assessment of market data need to be recognised in this context.

#### **The central role Exchange-Traded Derivatives (ETDs) play in efficient risk management is a key consideration**

- A review of position limits to allow new products to flourish should be an important objective as currently in practice the requirements have revealed themselves to be overly burdensome, impacting innovation and leading to some contracts moving to OTC trading or outside the EU completely;
- The removal of ETDs from MiFIR's 'non-discriminatory access' provisions is called for as otherwise it will pose significant challenges to the stability and liquidity of European derivatives markets for which there is no effective solution today - nor prospect of one in the future.

#### **Rising to the challenge of new technologies and climate change is integral to the future of European capital markets**

- Technological evolutions are likely to produce transformational changes across the entire capital markets' value chain. While technological developments should be embraced, it is also important to ensure a level playing field and to safeguard investors' protection;
- Supporting the EU in mobilising sustainable finance is key on all policy agendas and should be incorporated into all elements of CMU. Given the

urgent threat posed by climate change, capital markets have a crucial role to play in financing a future sustainable economy.

#### **Overall, we should be striving to maintain globally competitive European capital markets**

- Equivalence that preserves market stability as well as open, competitive and global markets with a distinguished approach between equity and derivatives markets;
- Finally, a mechanism should be created to ensure a level playing field for financial services providers based in the EU and equivalent third countries.





# LIST OF PRINCIPLES TO TAKE THE CAPITAL MARKETS UNION FORWARD

The CMU should:

- ▶ **1** Be framed around a holistic regulatory agenda;
- ▶ **2** Increase the overall size of EU public capital markets;
- ▶ **3** Strengthen supervisory convergence while preserving the role and value of national competent authorities (NCAs);
- ▶ **4** Remove fiscal disincentives against equity financing;
- ▶ **5** Reject the adoption of transaction taxes given the detrimental impact this would have on public capital markets;
- ▶ **6** Support measures to foster financial literacy for both investors and entrepreneurs;
- ▶ **7** Increase levels of retail investor participation in public capital markets;
- ▶ **8** Increase levels of institutional investor participation in public capital markets;
- ▶ **9** Support local ecosystems;
- ▶ **10** Support an increase in the proportion of price forming trading taking place on lit trading;
- ▶ **11** Promote liquid markets with efficient price formation;
- ▶ **12** Ensure that market data issues are assessed holistically, with a focus on assessing the entire industry value chain and safeguarding price formation;
- ▶ **13** Allow benchmarks to serve the economy as already intended by current legislation;
- ▶ **14** Support a position limits' regime that allows new products to flourish;
- ▶ **15** Support an extension of the EMIR clearing obligation to all standardised derivatives contracts;
- ▶ **16** Support the removal of ETDs from MiFIR's 'non-discriminatory' access provisions;
- ▶ **17** Safeguard a level playing field of activities in the field of new technologies by applying the principle "same business, same rules";
- ▶ **18** Support Europe in mobilising sustainable finance;
- ▶ **19** Ensure that an EU equivalence regime preserves market stability as well as open, competitive and global markets;
- ▶ **20** Ensure that EU equivalence rules do not unduly restrict market innovation and the ability to provide EU investors with access to global capital markets.

## | 1 | EXCHANGES AT THE CORE OF THE CMU

Capital markets facilitate capital formation, supporting risk management and funding the economy.

Exchanges are fair, orderly and transparent marketplaces where companies access capital by meeting private and institutional investors in exchange for returns. The primary market – the market for new issues of securities where companies issue shares directly to shareholders – plays a vital role in helping companies raise capital to finance innovation and growth. The secondary market – the market where previously issued shares are bought and sold – brings buyers and sellers together to trade stocks, bonds, derivatives, currencies, and any other financial instruments.

Exchanges provide the infrastructure for public capital markets and offer an alternative source to bank financing for capital raising. They have three key end-users: companies, governments, and investors.

Exchanges contribute to financial stability and economic growth by performing three main functions:

- **Funding** – allowing companies to raise capital by listing on public markets;
- **Trading and price formation** – providing investors with the possibility to buy and sell financial instruments in a transparent marketplace by offering price formation;

- **Risk management and financial stability** – giving companies and investors access to risk management products, such as derivatives cleared in a clearing house.

Exchanges are vital for the real economy<sup>4</sup>. Their contribution reaches far beyond the exchange of goods and services and price discovery. They enable the production of ex-ante and ex-post information on capital allocation and corporate governance.

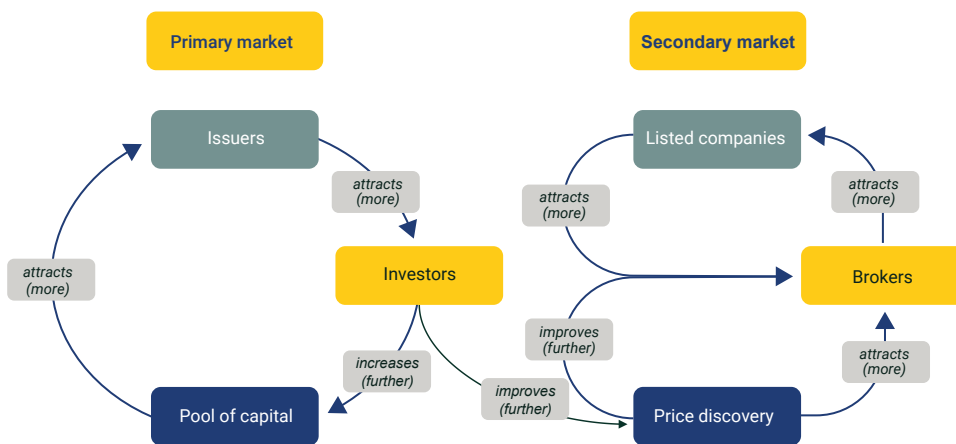
Whilst recognising the importance of banks for financial intermediation, the overreliance of European firms on bank lending compared to market-based financial structures has been identified as a significant obstacle to the resolution of the financial crisis and the recovery<sup>5,6</sup>. Exchanges facilitate the access of borrowers to funds, and provide them with investment opportunities and investor protection, reduce their capital costs, and diversify their funding sources<sup>7</sup>.



## | 1.1 | About Exchanges

Exchanges provide a central marketplace by matching supply and demand for listed instruments. They offer price formation and price dissemination and are highly regulated entities subject to harmonised European rules that ensure the integrity of the market.

**They enable the financing and risk management** of companies of all sizes via a wide range of instruments (equity, bonds and derivatives) and operate through primary and secondary markets.



Source: Oxera

**Primary markets** bring companies (i.e. issued securities) and investors together to distribute newly issued equities, bonds, derivatives or other financial instruments to retail and institutional investors. This provides issuers with access to a deep and diversified investor base consisting of local, national and international investors.

At the same time, Exchanges enable issuers to grow by:

- Improving capital raising on a continuous basis, which can be used for organic growth or to fund acquisitions;
- Giving eligibility for inclusion in indices;
- Improving corporates' reputation and profile, both externally and internally. i.e. securities admitted to trading on Exchanges have to comply with comprehensive initial and ongoing disclosure requirements as well as accounting and auditing standards imposed by EU laws;

- Increasing their visibility both to attract clients, high-profile employees and world class talent;
- Enabling them to offer share option incentive, which again increases the ability to attract, employ and retain high-quality talent;
- Fostering innovation by providing funding, without which innovation cannot take place. Exchanges themselves are examples of constant innovation as they are highly technological companies.

**Secondary markets** bring buyers and sellers together in a central, open and efficient market by matching supply and demand of previously issued securities. They create trust and certainty by providing transparent information on all instruments that are traded with full dissemination of real-time, reliable and comparable market data.

The trading landscape, i.e. that of secondary markets, includes multilateral and bilateral trading. The main differences between them are:

Multilateral trading faces full-market duties, such as:

- The orders are published ('pre-trade' transparency);
- The trades are immediately published; ('post-trade' transparency);
- All trading members can participate (open & fair access);
- Same outcome for all participants ('non-discretionary' execution);
- Market surveillance.

Bilateral trading (i.e. between an investment firm and a single client), in contrast, is subject to a more limited set of requirements:

- The trades are bilaterally executed on own account to earn from the spread ('proprietary trading');
- The trades are published ('post-trade' transparency);
- Investment firms' quotes are subject to limited publication requirements in certain cases ('pre-trade' transparency).

After the introduction of the Markets in Financial Instruments Directive I (MiFID I) in 2007, the trading landscape changed significantly and more so in 2018 following the subsequent review of MiFID I (MiFID II).

A key objective of MiFID I was to introduce competition in the trading space and to capture trading on either Regulated Markets (RMs), Multilateral Trading Facilities (MTFs) in relation to multilateral trading, or Systematic Internalisers (SIs) in relation to bilateral trading.

Following the rise of dark OTC trading conducted through Broker Crossing Networks (BCN), MiFID II was drafted to tackle the issue of transparency and to ensure that competitors, carrying out the same activity, are regulated in the same way. This was important not only to ensure fair competition but also for investor protection, legal clarity and market integrity.

Transparent trading on exchanges plays a central role in price formation, which contributes to fairer and more efficient markets and lower costs of capital for European companies. Whilst recognising that for larger trades there may be a need for alternative execution methods to negate the potential effects of market impact, price formation and transparency are beneficial to all market users.

## | 1.2 | The main asset classes operated by Exchanges

Exchanges admit to trading a full range of publicly issued financial instruments across a wide range of asset classes, the main ones are:

### Equities

Equity securities are financial instruments that represent ownership in a company's net assets. Companies issue shares in order to raise capital by giving up a portion of their ownership. Equities can be classified in terms of their voting rights e.g. in common or preferred stocks. Public equity funding allows companies to raise funds by providing them with access to a large pool of private and institutional investors. Equities can offer higher returns than other securities like bonds but are a riskier form of investment. Equity financing allows companies to raise large amounts of capital without taking on debt.

Equities derive their value from factors such as the company's cash flows, profits, and prospects. Additionally, they have two important characteristics affecting their pricing: divisibility (the ability of companies to expand the absolute amount to be raised) and transferability (the ability of investors to transfer possession of equities to another investor).

### Derivatives

Derivative securities are financial instruments that derive their value from the performance of an underlying asset. They transfer risks from one party to another by allowing for the separation between ownership and participation in the market value of an asset. There are several types of derivatives' instruments, such as futures, forwards, options and swaps.

The most common way of 'hedging' investments is through derivatives, A 'hedge' is an investment to reduce the risk of adverse price movements in an asset protecting a financial position against unexpected developments. For example, Commodity derivatives are used by farmers and manufacturers to provide a degree of insurance: the farmer enters the contract to lock in a price for the commodity, and the manufacturer enters it to lock in a supply of the commodity. Parties will have reduced their risk by hedging, i.e. the extent they can be impacted by price changes.

Derivatives can be exchange-traded (ETDs) or bilaterally-traded over-the-counter (OTC) (i.e. contracts

made directly between non-exchange counterparties). Generally, OTC derivatives are less standardised and involve counterparty credit risk or exposure between the parties. In contrast, ETDs benefit from the transparency and price discovery of Exchanges and the clearing and settlement by a Central Counter Party clearing house (CCP) transforming the counterparty credit risk to the CCP.

When it comes to derivatives trading, capital markets with deep pools of liquidity across different market segments can act as a strong stabilisation force in times of crisis by diversifying sources of finance. Even more so, the criticality of liquid and transparent markets becomes obvious on risk transfer markets which heavily rely on the liquidity found in ETDs. In critical market situations, liquidity in bilaterally-traded products does not allow for efficient risk management. This is precisely the time when market participants turn to liquid markets in legally certain environments – the 'flight to quality' principle.

Prior to the financial crisis, a large portion of derivatives transactions were OTC. Post-crisis, the G20 commitment to reform OTC derivatives markets<sup>8</sup> reduced market opacity by driving OTC transactions onto Exchanges and imposing a clearing obligation through CCPs.

### Funds / Exchange Traded Funds (ETFs)

ETFs are financial instruments with continuous pricing and liquidity that track the performance of an index or follow specific investment strategies. ETFs benefit from the liquidity and transparency of exchanges, they issue shares of a portfolio tracking a pool of assets and give a return proportional to the performance of that underlying, i.e. they are straight pass-through instruments.

ETFs constitute a disruptive trend in asset management, they offer gains in cost efficiency given that they do not bear the costs of active management. They also provide investors with easy access to diversification by covering a broad range of asset classes.

## Bonds

Bonds are financial instruments that allow public sector entities (i.e. governments, regional and local authorities and supranational institutions) or companies to raise funds by issuing debt without giving ownership rights.

Public sector entities for example, governments, issue bonds to borrow money to cover the shortfall between the amount they raise through taxes and the amount they spend.

Private entities, such as companies, issue bonds to raise funds to support investments, e.g. an expansion, without giving up ownership of the company.

Companies access bond markets as an alternative to bank loans, which may not be available to them on the scale needed. Bonds generally allow for large amounts of capital to be raised and are largely focused on

primary issuance. Whilst secondary trading does occur, a significant proportion is bought at primary and held to redemption. Bonds trade in bigger sizes than other instruments.

Bond investors receive stable and predictable repayments on their investment, which is why they are called a fixed income instrument.

Bond markets have gradually become digitalised. Exchanges and other trading venues now trade bonds providing transparent and neutral price-formation. Nevertheless, an important share of over 90% of bonds still trade over-the-counter (OTC).

## | 1.3 | The unique features of an Exchange

**Exchanges play a central role in price formation, risk management and maintaining and managing listing requirements.**

Exchanges have a pivotal role to play in connecting different market segments and investment perspectives and bridging the gap between the need for capital-raising on primary markets and price discovery and risk-transfer on secondary markets.

Exchanges fulfil a public function by operating public platforms open to all participants that meet a non-discretionary membership criterion (i.e. trading members) on a neutral and transparent basis (i.e. exchanges are not party to transactions, they merely provide the necessary infrastructure for these to be carried out).

Beyond the abovementioned functions, Exchanges also undertake a broader range of activities, including price formation, setting open and transparent trading rules as well as compliance and enforcement of those rules.

Exchanges provide an open and transparent interaction of demand and supply for financial instruments. Market data is the outcome of a dynamic price formation process and is a “joint product” with trade execution (i.e. it is not possible to generate one without the other), and most activities undertaken by an Exchange deliver both trading and price formation. Public markets operated by Exchanges stand for consistent and comparable reference of prices across venues. They are the “lighthouse” for reference prices across all types of trading.

Transparency is key to delivering price formation. Exchanges compete amongst themselves on the

quality and reliability of the price formation, for which sophisticated IT and compliance systems are put in place, to secure the fairest and most efficient outcome for brokers and retail and institutional investors.

Without the price formation mechanism on Exchanges, none of the alternative trading venues nor banks which internalise trading could trade efficiently. For instance, when trading on the Exchanges’ regulated markets is halted, trading venues reliant on price formation created at the Exchange, also put their trading on hold.

This is because some types of alternative execution venues organise trading by relying on imported reference prices from Exchanges<sup>9</sup>. This contributes towards an overall weakening of the quality of the price formation process by diverting order flow to more opaque execution venues and reducing the diversity of trading interests on lit trading venues.

Exchanges also uphold high standards of corporate behaviour and investor protection by maintaining and managing their listing requirements. They play a very important role in contributing to an effective dialogue between issuers and investors and ensuring investors’ interests are appropriately represented and enforced. This quality assurance role is at the very heart of a well-functioning capital market and as such can also be regarded as a public good but requires significant resources (i.e. costs) by the Exchanges.

## | 1.4 | European Capital Markets versus US and Asia – how do they compare?

To compete on a global level, Europe needs to assess how they compare to the US and Asian markets.

In general, capital markets in Europe present a bias towards debt financing and show greater liquidity fragmentation. It does however have a significant share of the global trading in derivatives.

Moreover, secondary markets in Europe are not as liquid as US markets, with lower turnover and a greater proportion of trading taking place on dark venues<sup>10</sup>.

European capital markets provide good access to risk management products with a high proportion of derivatives to the underlying and transact a significant market share of the global foreign exchange (FX) and

interest rate derivatives (IRD) products – however, Europe’s position in global derivatives is concentrated primarily in the UK.

The proportion of trading in major equity indices going through “lit venues” is much lower in Europe than in the US and Asia, reflecting the greater fragmentation of the European venue landscape and the significant proportion of off-venue and dark trading.

### CAPITAL MARKETS KEY STATISTICS, 2018

		Europe	EU27	US	Asia
<b>Primary market</b>	Equity funding (% of GDP)	68%	50%	156%	97%
	Corp. debt funding (% of GDP)	77%	72%	114%	50%
<b>Secondary markets</b>	Equity turnover velocity	112%	155%	161%	112%
	Equity turnover (% of GDP)	76%	78%	252%	108%
	Corp. debt turnover velocity	25%	22%	80%	n/a
	Corp. debt turnover (% of GDP)	19%	16%	91%	n/a
<b>Derivatives</b>	Notional value traded (x cash securities)	40x	25x	35x	12x
	Notional value traded (x GDP)	84x	46x	128x	25x
	Market share of global FX market	49%	12%	17%	27%
	Market share of global commodity market	19%	3%	66%	14%

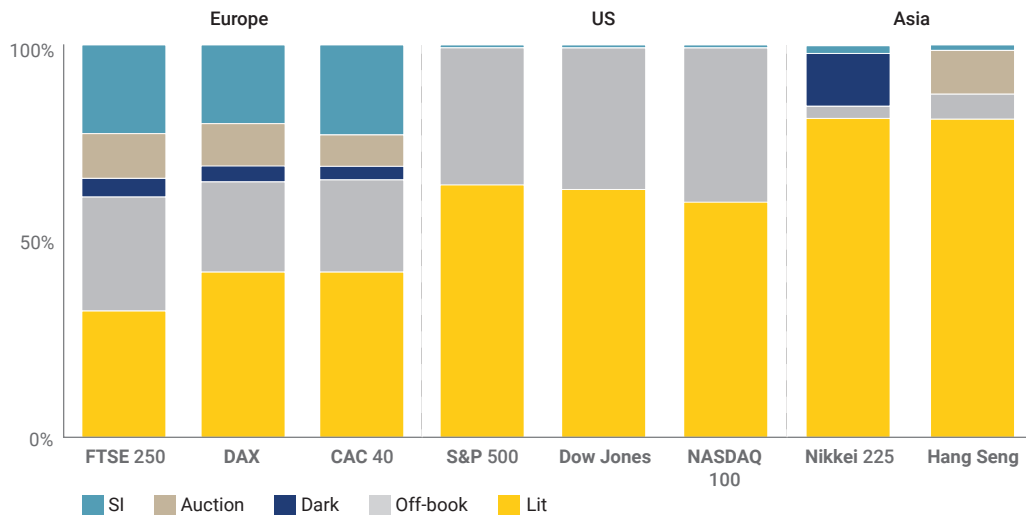
Low     Medium     High

Corporate debt secondary markets data for 2016  
 Note: Europe includes EU28 countries as well as Norway and Switzerland  
 Source: Oliver Wyman analysis





**TRADING VALUE FOR MAJOR EQUITY INDICES BY REGION, 2018**  
% OF TRADING VOLUME

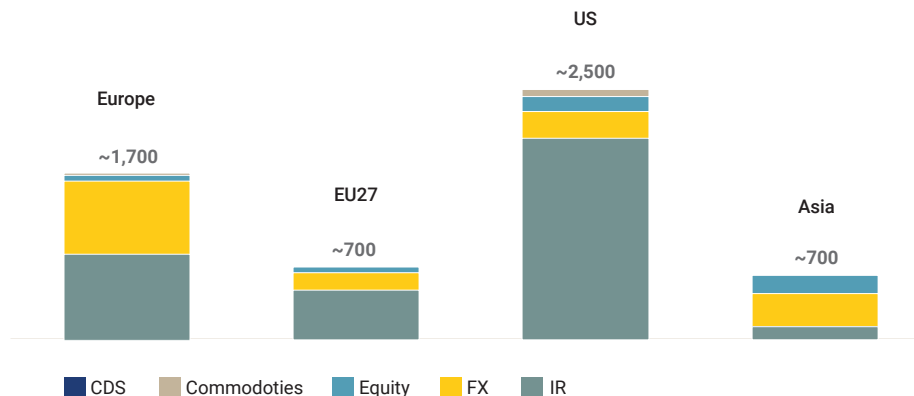


Source: Fidessa Fragmentation Index  
Note: "Lit" indicates trades executed on-book. "Off-Book" indicates trades executed over the counter and reported to one of the reporting venues. "Dark" trades executed on a dark pool where the orders are not visible pre-trade. "SI" indicates trades executed by a Systematic Internaliser.

Foreign exchange (FX) and interest rate derivatives (IRD) account for most derivatives trading in all regions, predominantly on an OTC basis. Aggregated European derivatives markets amount to approximately USD 1,700 TN in notional value traded in 2018 (see figure below). The aggregated derivatives market of the EU27 countries is far smaller on account of the UK's dominant position in the European market.

The overall European derivatives market is smaller in the EU than the US market both in absolute terms and relative to GDP. The ratio of derivative trading volumes of the underlying equity and debt is higher in Europe, pointing to the relatively small size of European cash security markets highlighted in the previous graph.

**DERIVATIVES MARKET (ETD AND OTC) SIZE BY REGION, 2018**  
NOTIONAL VALUE TRADED IN TN\$



**PENETRATION RATES BY REGION, 2018**  
Total derivative rates by region

/GDP	84x	46x	128x	25x
/Cash securities	40x	25x	35x	12x
	Europe	EU27	US	Asia

Source: WFE; BIS; Oliver Wyman analysis; WFE/IOMA (2011), "Derivatives Market Survey"; Ehlers & Eren (2016), "The changing shape of interest rate derivatives markets"; McCauley & Wooldridge (2016), "Exchanges struggle to attract derivatives trading from OTC markets".

## | 2 | WHAT IS NEEDED TO IMPROVE EUROPEAN CAPITAL MARKETS?

The Capital Markets Union (CMU) is a key initiative in the EU's long-term endeavour to foster financial integration and resilience. While freedom of movement of capital has been a long-standing goal of the EU, national lines have, however, long created a home bias in capital markets<sup>11</sup>.

Lowering the dependence on bank-based financial systems and increasing cross-border capital market integration will foster better growth performance and risk sharing<sup>12</sup>.

Considerations and analysis such as these provide the context and rationale for the six themes under which the main initiatives proposed in the CMU<sup>13</sup> were framed.

These themes are:

- Financing for innovation, start-ups, and non-listed companies;
- Making it easier for companies to enter and raise capital on public markets;
- Investing for the long-term, infrastructure, and sustainable investment;
- Fostering retail and institutional investment;
- Leveraging banking capacity to support the wider economy;
- Facilitating cross-border investing.

Two years ago, the Commission published a mid-term review<sup>14</sup> assessing the progress of the CMU and adding new priorities such as crowdfunding and fintech, sustainable finance, and local and regional capital market developments. Together with the Banking Union<sup>15</sup>, the CMU has fostered a general trend towards integration in European capital markets<sup>16</sup> however there is room for further progress<sup>17</sup>.

FESE fully supports the Commission's work in the context of the CMU and the objectives on which the CMU is based. In this chapter, we take stock of the progress made by CMU through what we call FESE's CMU Key Principles. These are based on the six themes included in the original European Commission Action Plan<sup>18</sup> alongside the recommendations suggested in the previous edition of the FESE Blueprint<sup>19</sup> and the report on 'Strengthening Europe's Position in Global Capital Markets'<sup>20</sup>.

For each principle, we provide an overview of the:

- (i) Initial FESE Objective(s);
- (ii) Current Situation;
- (iii) Outstanding Challenge(s); and
- (iv) FESE Recommendation(s).

**The aim of the principles and recommendations is to provide suggestions for the creation of a genuine and comprehensive CMU.**



The Capital Markets Union (CMU) is a key initiative in the EU's long-term endeavour to foster financial integration and resilience.

## | 2.1 | Overall Ambition and Approach

A successful CMU continues to be a strategic need for Europe. European policymakers must commit and take decisive steps towards tangible objectives that will make the EU attractive to global capital and companies, while at the same time ensuring transparency, integrity, and investor protection. To achieve this goal, FESE believes that a holistic approach of regulatory initiatives must be undertaken to strengthen the role of public capital markets and remove barriers for companies and investors.

<b>FESE CMU KEY PRINCIPLE 1: CMU should be framed around a holistic regulatory agenda</b>	
Initial FESE Objective:	Support an ambitious CMU agenda.
Current Situation:	Many issues underpinning the CMU objectives are found in areas of EU legislation – such as MiFID II or Benchmarks Regulation (BMR) – which to date have not explicitly been the subject of the CMU agenda.
Outstanding Challenges:	Need to ensure a coherent and holistic regulatory agenda to deliver the CMU objectives.
FESE Recommendation:	Integrate upcoming reviews of EU legislation (namely MiFID) into the CMU. Ensure that regulatory outcomes are aligned, and adopt a new approach aimed at improving and recalibrating the regulatory and supervisory framework where necessary, rather than introducing new regulation.

The next European Commission mandate provides an opportune moment to reframe CMU around a holistic regulatory agenda to ensure that regulatory outcomes are aligned and avoid contradiction.

Accordingly, the CMU policy approach would benefit from integrating upcoming reviews of EU legislation. Primarily, MiFID II, as this framework is the single most important piece of EU legislation impacting our ability to finance national and European economies. Moreover, the same approach should also apply to all other relevant EU legislation, such as the Market Abuse Regulation (MAR), Prospectus Regulation as well as the Transparency and Listing Directives to name but a few.

Legislative reviews, embedded within the CMU process, should encompass an approach to evaluation which delivers:

- A clear benchmarking of regulations' market outcomes against the initial objectives;
- Economic impact assessments, which include a strong focus on the macroeconomic impact of

regulations on the national and local ecosystems;

- A comprehensive approach covering all participants in the market ecosystem and value chain, particularly when it comes to determining end-user costs.

Regulators should avoid a 'one size fits all' approach, especially when it comes to equity and non-equity, as this approach would have a significant impact on markets. Future legislative proposals should be based on a comprehensive review process that would demonstrate a clear relevance and benefit to the development of the CMU agenda. To be succinct, thorough analysis and impact assessments should be carried out, with empirical evidence supporting the value each initiative contributes to CMU.

**FESE CMU KEY PRINCIPLE 2:**  
**CMU should increase the overall size of EU public capital markets**

Initial FESE Objective:	Increase the size of capital markets in the EU by reaching a 100% stock market capitalisation relative to EU GDP by 2020.
Current Situation:	Europe's average stock market capitalisation of EU GDP is approximately 75%.
Outstanding Challenges:	Ongoing issues of attractiveness of public capital markets in the EU, in respect of other financing options and alternatives in other regions (US).
FESE Recommendation:	Reaffirm the goal of reaching a 100% stock market capitalisation of EU GDP by the end of the next legislative term (2024).

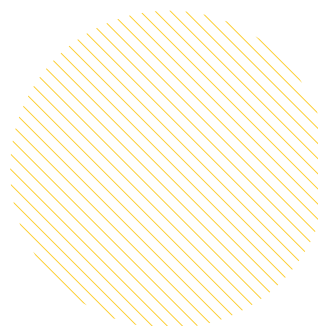
In an environment in which the EU must reduce its dependence on bank lending, economic development can only be financed through a greater share of financing from capital markets. The need to develop market-based financing has been recognised at the highest political levels in the EU and remains one of the core objectives of the CMU initiative. Nevertheless, the EU's capital markets are still far from meeting these objectives as, by various indicators, European markets are failing to catch up with their peers from the Americas or Asia.

In the previous edition of the FESE Blueprint<sup>21</sup>, we suggested that Europe should set itself the goal of reaching a 100% stock market capitalisation relative to EU GDP by 2020. Regrettably, this goal will not be reached as, at the end of 2018, the stock market capitalisation of the EU was approximately 75% while the debt market capitalisation was over 80%.

The EU needs to be more ambitious and should aim at significantly increasing the size of equity financing in relative terms to GDP. 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. Facilitating capital markets towards contributing further to this goal would serve the EU objectives on employment, innovation, education, social inclusion and mitigating climate change. Reaching a stock market capitalisation of 100% of the EU GDP is not unachievable and we call for this to be a clear objective in the CMU agenda.

To achieve this and to serve the original goals of the Single Market, a fundamental reorientation of European policies is needed. In the rest of this section, we include a series of measures that, paired with the ongoing measures outlined in the CMU, will help reach the objective of 100% stock market capitalisation by 2024.



**FESE CMU KEY PRINCIPLE 3:**

**CMU should strengthen supervisory convergence while preserving the role and value of national competent authorities (NCAs)**

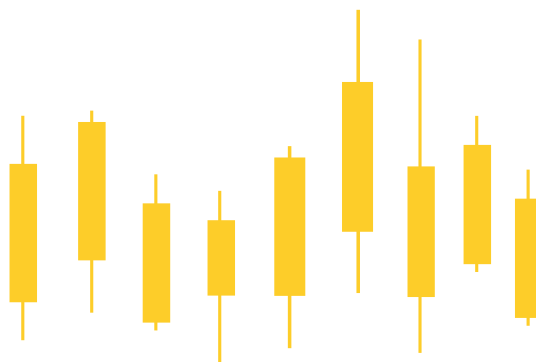
Initial FESE Objective:	Promote the development of a consistent European regulatory and supervisory framework for the financial sector.
Current Situation:	Positive overall working of European Securities and Markets Authority (ESMA) and adoption of the European Supervisory Authorities (ESAs) Review.
Outstanding Challenges:	Strengthen supervisory convergence within ESMA's tools and structures while taking full advantage of national competent authorities' (NCAs) competence and knowledge.
FESE Recommendation:	Ensure a streamlined interaction and proper allocation of roles between the ESAs and national regulators, prioritising strengthened supervisory convergence over the granting of direct supervisory powers to ESMA.

Through their RM and MTF operations, Exchanges are regulated by their NCAs. The EU has set itself the objective of promoting a common supervisory culture and fostering supervisory convergence across the Union. In this regard, we welcomed the ESAs Review agreement<sup>22</sup> as a way to improve the ESAs' functioning and to address existing gaps which prevent the ESAs from correctly fulfilling their respective mandates, including the promotion of a common supervisory culture. The ESAs play an important role in reducing barriers to cross-border investment and ensuring best practice coordination and convergence across the single market.

With the ESA Review now agreed, ESMA's work on supervisory convergence needs to be strengthened, particularly in respect of diverging supervisory practices across Member States.

At the same time, greater supervisory convergence should not automatically undermine the local competencies and expertise of the NCAs. Streamlined interaction and proper allocation of roles between ESMA and NCAs are vital elements of the supervisory system, bringing together local expertise, direct contact with entities and, crucially, local accountability, with a European overview of supervisory standards and convergence practices.

Lastly, given the global dimension of capital flows and how important it is for European markets to fit into a globally competitive model, FESE would strongly recommend that ESMA always considers the international dimension, such as the work of IOSCO, to ensure that EU guidelines do not differ significantly from international standards or create additional barriers.

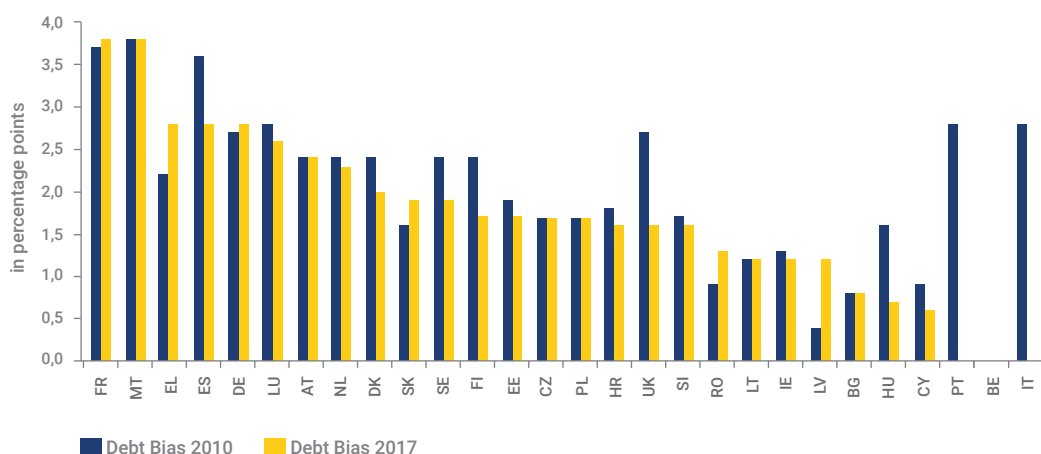


**FESE CMU KEY PRINCIPLE 4:**  
**CMU should remove fiscal disincentives against equity financing**

Initial FESE Objective:	Ensure a fair treatment of equity financing.
Current Situation:	Persistent tax-based bias towards debt financing.
Outstanding Challenges:	Need to rebalance the current tax-based bias for the benefit of both companies and investors.
FESE Recommendation:	Review fiscal incentives against equity financing in Europe.

From a company/issuer perspective, equity is more heavily taxed than debt in most countries, which creates a disincentive for equity investment (the graph below shows the evolution and the persistence of the debt bias in the EU over the past years). 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 encourages risk-taking, often at the expense of creditors rather than shareholders<sup>23</sup> and as we have seen, in some instances, of taxpayers too. Only equity can supply a reliable risk buffer against external shocks.



Source: ZEW, "Final Report 2016: Effective Tax Levels Using the Devereux/Griffith Methodology" (Mannheim, 2017).

Rebalancing the current bias towards debt financing by alleviating the burdens on equity finance to create a level playing field should be at the core of CMU for two reasons. Firstly, it should 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 should result in investors paying lower taxes on their equity investments, incentivising

provision of equity capital as an alternative source of funding.

It is not only important to rebalance this bias, but also to harmonise tax procedures.

We encourage EU policymakers to consider the different characteristics of public equity and debt markets when undertaking capital markets regulatory initiatives. Some of the fiscal arrangements currently

in place act as a barrier towards the development of public capital markets in the EU. A review of these arrangements should not result in the creation of a new fiscal imposition on debt financing, but rather at removing and alleviating the burdens on equity financing to create a level playing field.

Annual studies and surveys by the European Commission on tax policies in the EU<sup>24</sup> should also conduct a more in-depth impact assessment on the cost of capital arising from the current tax bias against equity investments. Currently, in many

European countries we either observe a lack of positive tax incentives, or the presence of significant disincentives, whereby the tax system is more favourable to debt issuance than to equity. To orient more investor/investment flows into listed equity, bond and derivatives instruments, new or existing tax and regulatory disincentives that suppress investor demand should be avoided.

Such changes would have a positive impact on the overall attractiveness of European public capital markets.

**FESE CMU KEY PRINCIPLE 5:**

**Reject the adoption of transaction taxes given the detrimental impact this would have on public capital markets should be removed under CMU**

Initial FESE Objective:	New tax policies discouraging investors from investing in capital markets, in particular in listed instruments, should be avoided.
Current Situation:	Ongoing discussions on a Financial Transaction Tax (FTT) linked to the EU budget.
Outstanding Challenges:	Avoiding taxation initiatives undermining CMU.
FESE Recommendation:	Avoid any measures that would disincentivise investing in capital markets.

As highlighted in the previous edition of the FESE Blueprint, any new tax policies (including proposals such as the Financial Transaction Tax (FTT)) which would discourage investors from investing in capital markets, in particular in listed instruments, should be avoided.

We urge policymakers to fully consider the implication of new tax policies that could be detrimental to EU financial markets and their users, increase distortion on the market and potentially weaken EU competitiveness.

Defining the right regulatory and tax environment is key to creating a bigger “demand” side for capital markets and enhancing Europe’s global positioning.

In the absence of global or even EU-wide cooperation, it is important to carefully assess the consequences of further taxation of financial activities. Many of the transactions subject to a tax would relocate to non-cooperating countries, thereby reducing revenue prospects, impacting the effectiveness of supervision and increasing fragmentation.

## | 2.2 | Funding the Economy: Serving Investors and Companies

In its original Action Plan<sup>25</sup>, the European Commission stated that the CMU will strengthen the link between savings and growth. FESE is fully aligned with the goal to mobilise capital in Europe and channel it to all companies, including SMEs, infrastructure and long-term sustainable projects. CMU should deepen local ecosystems and provide the tools and the regulatory framework for those market participants who want to grow and expand both at national level and cross-border.

Moreover, legislation should move towards even more market orientation. Europe’s capital markets will be best served if policymakers continue to identify areas where further harmonisation can remove unnecessary barriers to cross-border investments. For instance, the recent case of Spotify (the music streaming subscription service founded in Sweden in 2008) shows that one of the largest listings to be issued in the EU decided to go public in the US in April 2018.

This strategic decision underlines the fact that Europe has the capacity to grow innovative high-tech companies, yet fails to meet their needs when these companies want to scale-up. The extra expense deriving from having divergent regimes puts European firms at a competitive disadvantage vis-à-vis their international peers and creates difficulties for investors when analysing European companies.

Today, mid-market companies struggle to find brokers that are able to help them with the IPO process and provide the research needed. Another disadvantage is the lack of harmonisation of accounting rules and taxation base that makes analysis for investors more costly.

### **FESE CMU Key Principle 6: CMU should support measures to foster financial literacy for both investors and entrepreneurs**

Initial FESE Objective:	Fostering financial literacy for both investors and entrepreneurs.
Current Situation:	Low participation in capital markets, particularly by the SME ecosystem.
Outstanding Challenges:	Difficulties to strengthen a risk-taking culture among SMEs and SME investors.
FESE Recommendation:	Ensure public support and EU-wide initiatives to support Exchanges in their public good and educational activities.

There is a need to foster a culture of risk-taking among SMEs and SME investors as a means of creating more balanced public capital market structures. From both an investors’ and entrepreneurs’ perspective, education is key to building an equity culture. Financial education should be one of the core objectives of CMU.

Financial literacy rates vary widely across the EU and are particularly low in the Central, Eastern and South-eastern Europe (CESEE) countries<sup>26</sup>. Such low levels of financial education are a great impediment to a successful CMU.

On a domestic level, citizens who lack basic financial concepts are not well equipped to make informed financial choices regarding saving, investing, and borrowing<sup>27</sup>. In fact, less than half of European households (43%) invest in any type of financial product with the notable exception of Sweden—where more than 60% of households invest<sup>28</sup>. Promotion of public capital markets must go hand in hand with measures to sustain confidence in markets. In the coming legislative period, efforts should focus on improving financial literacy to facilitate access to direct investments.

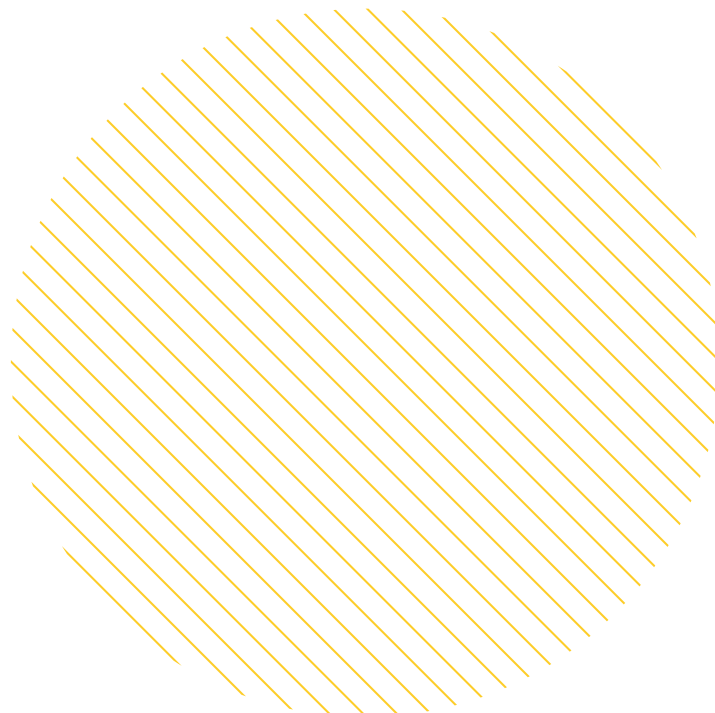
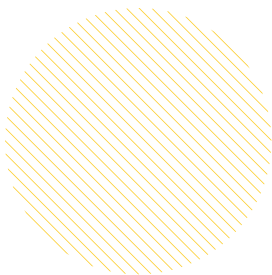


Whereas on a business level, promoting public markets as an alternative funding source, open to SMEs in particular, would be welcome, providing further support in strengthening information on the pre-IPO phase would be complementary to what is already being done by Exchanges. For example, FESE Members already support companies looking to raise capital in the pre-IPO stage through their own programmes: Athens Stock Exchange 'Roots'; BME 'Pre-Market Environment'; Boerse Stuttgart 'Nordic Pre Market' (for the Nordics) and 'Startbase' (for Germany); Deutsche Boerse 'Venture Network'; Euronext 'FamilyShare', '#IPO Ready' and 'TechShare', and Nasdaq Stockholm 'EIC Investor Day @ NASDAQ'. Companies taking part in these programmes are future IPO candidates and are dependent on funding for further growth.

These programmes:

- Connect SMEs to investors and help them gain access to professional services;
- Provide stakeholder coordination and management;
- Provide due diligence and prospectus writing, investment case development;
- Provide IPO roadshow support and financial public relations and marketing services.

Further recognition through EU-wide initiatives, for example in the context of the upcoming InvestEU framework<sup>29</sup>, which would support Exchanges in their information activities, is welcome. This support could intervene at different levels of financial education: educating large companies about transparency and corporate governance on the one hand, while focusing on alternative sources of funding by listing on SME markets for smaller companies on the other. This would be especially beneficial to smaller markets, which do not have the resources to run such large-scale educational initiatives on a continuous basis.



## | 2.2.1 | Serving Investors

### FESE CMU Key Principle 7: CMU should increase levels of retail investor participation in public capital markets

Initial FESE Objective:	Increase overall retail investor participation.
Current Situation:	Fragmentation of capital and financial services markets for individuals.
Outstanding Challenges:	Promote well-regulated financial instruments such as equities, bonds and ETFs as a simple, cheap, liquid and transparent long-term investment tool.
FESE Recommendation:	Conduct a review on the impact of MiFID II's inducement rules on the way equities are distributed to investors and on research coverage of SME and mid-cap companies.

The role of capital markets is to provide adequate and attractive funding for issuers of equity and debt, while providing end-investors with a decent and sustainable return on investment.

We support the three main strands of work identified by the European Commission in its 2017 Consumer Financial Services Action Plan, namely to:

- Increase consumer trust and empower consumers when buying services at home or from other Member States;
- Reduce legal and regulatory obstacles affecting businesses when providing financial services abroad, and
- Support the development of an innovative digital world which can overcome some of the existing barriers to the Single Market.

Consumers have much to gain from a true Single Market in financial services, working towards the removal of all remaining substantial barriers to integration should remain a priority.

Promoting well-regulated financial instruments such as equities, bonds and ETFs as a simple, affordable, liquid and transparent long-term investment tools should be at the core of CMU's objective to raise investor participation. Investors need a choice of well-regulated instruments, diverse ways of accessing the markets, and transparency in a cost-effective manner.

This objective could be structured around two main areas:

#### 1. Direct investment in equities & taxation issues

The Pan-European Personal Pension Product (PEPP)<sup>30</sup> can be one of many potential tools which could unlock funding and allow it to flow directly without intermediation costs from Europe's savers to Europe's businesses. Had the PEPP offered retail savers with the option to make direct investments in shares and bonds<sup>31</sup>, it would have resulted in an increase in the funding options for firms<sup>32</sup>, i.e. retail investors could have had the choice on what they invest in. The greater the investor's choice, the greater the competition. Therefore, policy makers should look closer at this product again and try to ensure it will be used as a further choice for investors to invest pan-European.

Alternatively, policy makers should also seek other types of investment products – like PEPP – which would allow direct investments into equities.

A PEPP and other more direct products designed in this way could help to achieve the key objectives of CMU through channelling retail savings into capital markets and supporting retail investors in making provisions for their own personal retirement savings.

However, several obstacles hinder the creation of this form of PEPP and/or other direct products both at EU and Member State level.

Currently, each Member State has divergent taxation rules, legislative barriers and legal requirements that make it unfeasible to develop cross-border savings<sup>33</sup>. As the taxation rules are not within the EU authority, measures should be drafted on how to decrease the legislative and legal hindrances. Policymakers should secure that investors would have the choice of where to put their pension.

As an overarching goal, end-users should get access to direct investments and financial incentives should be promoted to enable long-term direct investment. Supporting long-term, cost-effective investments, and specifically pension investments, is a highly effective goal because investors with a long-term outlook are crucial for well-functioning capital markets.

In line with Better Finance<sup>34</sup>, tax incentives for long-term and pension investors should be provided while existing tax discriminations for individual investors in the EU, such as double taxation of dividends, should be eliminated. While both tax incentives and double taxation issues are within the remit of EU Member States, the CMU should promote appropriate measures in this respect.

A variety of possibilities for end-investors in the sense of equity financing and investment has to be promoted. Retail savers should have the right to invest not only through products such as PEPP but also directly in indices based on national, regional, and pan-European equities. Indices used for benchmarking of those investments should be broad, representing both large enterprises and SMEs.

## 2. MiFID II inducement rules

MiFID II's inducement rules require reassessment, particularly their impact on equity research conducted on SMEs. Coverage is diminishing due to the regulatory requirements for research to be independent<sup>35</sup>.

The European Commission's call for tenders<sup>36</sup> for a study on the effects of MiFID II research payment rules on SME research and fixed-income investment research is timely. In particular, a review of the impact MiFID II has had on the quality and amount of research is an important step towards reviewing these rules and improving the situation.

### FESE CMU Key Principle 8: CMU should increase levels of institutional investor participation in public capital markets

Initial FESE Objective:	Increase institutional investors' participation and support long-term investing.
Current Situation:	There is significant potential for investment into long-term financial instruments by institutional investors (such as insurers, pension fund, asset managers). In some cases, restrictively high capital requirements impact their ability to maintain and develop long-term products and investments.
Outstanding Challenges:	Regulatory and tax disincentives against institutional investment & lack of visibility of smaller markets.
FESE Recommendation:	Review equity capital charges under Solvency II and bring many of the smaller EU markets with listed companies on investors' radar screens.

Alternative sources of funding should play a bigger role in providing finance for European companies. Having more diversified sources of financing is not only necessary to boost investment but is also essential to make the EU financial system more resilient.

Institutional investors, in particular insurance companies and pension funds, fulfil a critical role in the economy, channelling the savings of millions of people into investable assets<sup>37</sup>.

They play a key role in the development of financial markets as they:

- Represent the largest source of equity capital;
- Contribute to both efficiency and modernisation of the allocative mechanisms of a financial system, and
- Often support improvements in corporate governance practices by monitoring firms' management.

However, while institutional investors have traditionally been long-term equity investors in capital markets, equity investments by insurance companies are now below the level reached before the financial crisis. European insurance companies invest less in equity compared to third country insurers and to EU pension funds. The European Commission expects to validate this in the results of a study, on the drivers of investments in equity by insurers and pension funds, it has commissioned from the Centre for European Policy Studies (CEPS).

Although investors have regained confidence in financial markets in recent years, the levels of institutional investors' support remains limited since some of the current regulatory and fiscal arrangements in place act as a barrier to the development of public capital markets in Europe.

A review of equity capital charges under Solvency II should be a clear priority in order to remove one of

the important biases against equity investment. Under the regime insurers must, in most cases, hold a 39% capital charge to own shares in listed companies. This also applies in cases where these instruments are held with a long-term view, with investors having significant flexibility on investments/disinvestment decisions. Today, capital requirements do not fully permit a long-term view regarding investments: policymakers should investigate and address this deficiency.

To ensure a harmonised implementation of CMU, smaller EU markets must be put under the radar. In the long run, this increased visibility would have the effect of improving liquidity. Smaller markets are impacted by the effects of passive investments, therefore their inclusion in a broad market index has become increasingly important.

The classification of markets is a key objective in the process of index construction as it drives the composition of the investment opportunity to be represented. However, the classification of countries according to their development does not always reflect that certain conditions might be fulfilled through their participation in the Single Market and the application of the EU legal framework. In addition to the current methodologies, policymakers should promote a regional approach in assessing the economic development of smaller markets, e.g. this would be the case for the Baltic region or certain Central and Eastern European (CEE) markets.



## | 2.2.2 | Serving Companies & Local Ecosystems

<b>FESE CMU Key Principle 9:</b> <b>CMU should support local ecosystems</b>	
Initial FESE Objective:	Support local ecosystems as a bedrock to capital raising.
Current Situation:	Several barriers remain which inhibit the ability of EU public markets for SMEs to attract new issuers.
Outstanding Challenges:	Maintaining a diverse and dynamic mix of ecosystems within the EU Single Market, particularly needed in the context of Brexit. Harmonise insolvency, accounting and taxation rules to the extent possible.
FESE Recommendation:	<ul style="list-style-type: none"> <li>(i) Ensure coordinated developments of ecosystems;</li> <li>(ii) Embed proportionate regulatory frameworks;</li> <li>(iii) Consider the specificities of debt-only issuers, and;</li> <li>(iv) Consider a single set of accounting rules for finance and taxation.</li> </ul>

Exchanges are part of a complex and delicate ecosystem of important players – brokers, banks, advisers, analysts, auditors, lawyers, etc. – who must all come together to serve enterprises and households in different ways to serve the economy through financing, saving and risk management.

FESE Members operate successful models of services for SMEs however several barriers remain which inhibit the ability of EU public markets for SMEs to attract

new issuers<sup>38</sup>. Traditionally, the various players which make up the ecosystem of brokers, analysts and advisers catering to the needs of smaller companies and investors were incentivised to invest time and resources into building the demand for smaller IPOs, regrettably these services are disappearing. Consequently, this is reflected in the decreasing numbers of IPOs across Europe over the past few years.



Source: FESE and WFE

Recent financial regulatory initiatives, especially those launched in the aftermath of the 2008 crisis, have had the effect of:

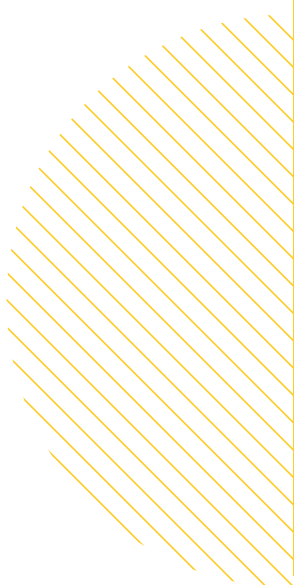
- Creating a 'one size fits all' regulation for companies, markets and/or financial instruments (equity vis-à-vis non-equity);
- Driving up costs for all companies looking to go public, thus reducing the supply of small and mid-cap companies in particular;
- Disincentivising investment in smaller companies and in equity overall;
- Shifting the economics of trading shares away from long-term investing and towards more high-frequency trading of larger company shares, thus making the IPO process less attractive for smaller companies;
- Eroding the local ecosystems of smaller brokers, analysts and advisers catering to the needs of smaller companies and investors. This has been the case, for instance, of MiFID, I and II, and MAR as both favoured blue-chips while creating unintended consequences for small brokers and SME markets.

Overall, the measures proposed by the European Commission under the CMU, notably those aimed at supporting SME listings, i.e. the revision of the Prospectus rules and the creation of a simplified EU Growth Prospectus, are a step in the right direction as well as additional measures proposed to promote the

use of SME Growth Markets. However more tangible benefits should be created to promote the use of this measure.

Many FESE Members have specialised markets that allow SMEs across Europe to access capital markets. On these markets, there is a continuous dialogue among various participants within the ecosystem about improving the rules tailored to local needs. It is important to keep the aim of finding the best balance between maintaining a liquid and trusted market with reduced burdens for issuers and adequate levels of investor protection. These markets, for those reasons, should retain a certain level of flexibility whilst ensuring efficiency and integrity.

EU policies can make a difference in preventing a further loss of the local and regional ecosystems by sustaining the full spectrum of players serving smaller companies and their investors. They also need to deliver a comprehensive strategy on how to boost equity and non-equity financing at all stages of the funding escalator.



## How to support the development of smaller markets within the CMU<sup>39</sup>

To ensure the success of CMU, boosting the development of smaller capital markets where the majority of the companies are SMEs and the investment gap still remains broad is key. For example, in the CEE region<sup>40</sup>, the average stock market capitalisation accounts for less than 20% of GDP (approximately) in comparison to an average of 75% of GDP in the EU.

FESE is a keen supporter of the development of local capital markets and has recently set-up an internal workstream dedicated to smaller markets<sup>41</sup>. This group has identified and analysed the main challenges faced by these markets, as follows:

- Lack of proportionality and resources;
- Lack of an equity culture;
- Lack of attractive stocks (few top performers, etc.) paired with a lack of harmonisation of investment rules;
- Lack of quality capital, especially related to innovation and intangible assets (research, skilled workforce, financial education, advisory services, etc.) – markets are dominated by SMEs without an adequate ecosystem to cater for their needs, especially from an investors' side;
- Lack of post-trade infrastructure;
- Lack of private pension schemes and missing capital market orientation;
- Low weighting market in international portfolios due to local market classification results, lack of research coverage and of trust in the local legal framework.

The development of these smaller markets will contribute towards the strengthening of European competitiveness on a global level.

In order to reduce burdens and barriers for both companies and investors the group identified four key areas:

1. **Ensure a coordinated development of ecosystems** by facilitating capital market convergence and benefitting from an EU integrated diversity of national ecosystems.
2. **Deliver a proportionate regulatory framework.** For smaller markets and smaller markets participants (for the latter, independently from the size of the market), the regulatory burden can sometimes be overwhelming. More precisely, the 'one-size-fits-all' model, mostly used in the context of EU level legislative frameworks, is less proportional for

smaller markets and brings excessive and disproportionate requirements for smaller services providers, thus making the overall market less competitive.

For instance, due to the full application of MAR to MTFs, issuers on these specialised markets need to apply the same requirements as the main markets. If we take the example of Poland, the average market capitalisation of a company listed on NewConnect is around 1.2 million EUR, while MAR outlines, for offences of insider dealing and market manipulation, a maximum fine of 5 million EUR for natural persons. Member States can also impose even higher maximum administrative fines.

This reality discourages smaller companies facing high compliance costs from remaining listed and as a result prefer to de-list and resort to private equity. We fully endorse the recent Level I measures adopted by the EU co-legislators to encourage SMEs listing (amending MAR and the Prospectus Regulation and the Level II changes to the Delegated Regulation under MiFID II) however, we believe that more needs to be done. EU regulators should run a comprehensive assessment of the impact of the various legislative files which might differ based on the size of the markets. It would also be helpful to consider forms of technical assistance to support the implementation of EU laws at national level. Furthermore, longer deadlines for transposition and implementation to give more time to market participants to get ready for the changes could be beneficial.

- 3. Protect small markets.** MiFID created unintended consequences for SMEs, as a result of market fragmentation and fragmented liquidity. To address this, an SME issuer asking for admission of its shares to the licensed public market should have the right to choose where to be traded to avoid fragmentation of already low liquidity, i.e. to limit the trading of its stock outside its primary market.
- 4. Develop an equity culture in Europe for both investors (retail and institutional) and entrepreneurs.** For instance, EU structural funds could be used to support listing of local SMEs, e.g. through the creation of an 'IPO Fund' to tackle the investment gap and cover part of the listing and transaction costs offering co-investments by state funds (currently state funds focus on private-equity style investments only). From an investor's perspective, the regulatory limitations for the investments from institutional investors should be reviewed. We call upon regulators to adopt a cross-cutting approach and analyse the various sectorial regulations, e.g. Solvency II, Institutions for occupational retirement provision (IORPs, etc.) that could prevent or limit investing in smaller markets and SMEs be institutional investors.



## | 2.3 | Fair and Orderly Equity Market Structure

MiFID II has failed in improving transparency. While MiFID I brought competition in equity trading which lowered trading fees and increased end-investor choice, there has also been a growth in dark trading, where transactions are executed with no pre-trade transparency. This consists of trading executed on periodic auctions, SIs and on an OTC basis.

After the implementation of MiFID II, the share of “lit venues” only accounts for 42.4%<sup>42</sup> of the total equity market share, while dark trading, e.g. off-venue trading on systematic internalisers (SIs), has picked up considerably. It should be noted that the MiFID I BCN trading volumes have shifted to SI reported trading instead of moving to multilateral trading venues. This shows a lack of implementation of the MiFID II rules.

**FESE CMU KEY PRINCIPLE 10:**  
**CMU should support an increase in the proportion of price forming trading taking place on lit trading venues**

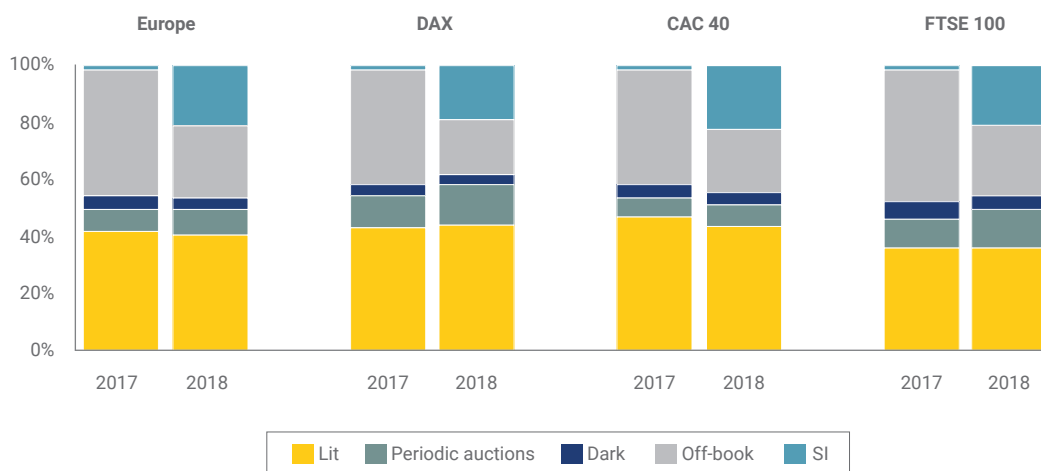
Initial FESE Objective:	Capture all price forming trades on lit trading venues.
Current Situation:	Post MiFID II application, the proportion of trading on “lit venues” accounts for only 42.4% of the total equity market share.
Outstanding Challenges:	Enforcement of trading rules in SIs as defined in MiFID II.
FESE Recommendation:	<ul style="list-style-type: none"> <li>(i) Address any deficiencies in the application of the legislative framework as a matter of urgency so as not to risk unintended changes in market structure becoming permanently embedded.</li> <li>(ii) Consider that capital markets with deep pools of high-quality liquidity are a crucial component of healthy ecosystems as well as an important contribution to competitive, transparent and stable EU financial markets.</li> </ul>

The MiFID I review, leading to MiFID II/MiFIR, was launched against the backdrop of the financial crisis which clearly displayed the shortcomings of opaque trading structures. The co-legislators chose to promote transparency and trading on lit markets and limit dark trading, recognising the role of Exchanges in reducing systemic risk, promoting safe and transparent markets and providing correct asset prices, including in volatile times.

In the year before the introduction of MiFID II/MiFIR, an average of 42.4% of European trading was done on trading venues – Exchanges or MTFs – where bids and offers were posted publicly. Surprisingly, after the introduction of MiFID II, lit market share, remained unchanged, in 2018 the lit market share averaged 42.4%.

The main shift went to SIs platforms that allow banks and electronic market-making firms to deal directly with selected counterparties at their own risk<sup>43</sup>. Furthermore, following the introduction of the MiFID II Share Trading Obligation, trading has moved from OTC to SIs which have grown both in terms of market share and number of operators. While these platforms are regulated under MiFID II, they provide less transparency than on Exchange trading, a factor which can be problematic when the distinction between purely bilateral and more hybrid multilateral trading on them which they also engage in is blurred.

## EUROPEAN EQUITY TRADING VALUE, 2017 AND 2018



Note: 'Lit' indicates trades executed on-book. 'Dark' indicates trades executed on a dark pool where the orders are not visible pre-trade. 'SI' indicates trades executed by an SI. 'Off-Book' indicates trades executed OTC and reported to one of the reporting venues.

Source: Oxera

As outlined in Section 1.4, secondary markets in Europe differ from other regions. The proportion of trading on "lit venues" is much lower in Europe than in the US and Asia, which provides a clear indication of how fragmented and opaque markets are in Europe. While competition, as enabled by MIFID, has driven a decrease in trading costs, European secondary markets have also become more fragmented and do not enjoy a truly transparent liquidity pool. With only a little over 40% of trading occurring on lit venues, it has a direct effect on market quality and an impact on the price formation process. This results in a less efficient allocation of capital to the detriment of issuers and investors.

The change of market structure in equities is partly driven by an unlevel playing field as SIs were not subject to key provisions applicable to trading venues in terms of how orders are published and executed. While trading venues must comply with standardised tick sizes<sup>44</sup>, established under MIFID II, SIs were, until now, not subject to the same conditions. However, this has

been recently addressed in the Investment Firm Review (IFR) which has amended MiFIR to require tick sizes to apply to all SI trading below the large-in scale threshold which is a step in the right direction towards allowing competition on a level playing field.

Looking ahead to further initiatives under CMU, policymakers and regulators should reflect on the type of market structure they would wish to see developing and in doing so consider that capital markets with deep pools of transparent, high-quality and diverse liquidity are a crucial component of healthy ecosystems<sup>45</sup> as well as an important contribution to competitive, transparent and stable EU financial markets.

A key part of this should also focus on ensuring effective enforcement of the rulebook via national regulators and, where it would be beneficial to ESMA.

**FESE CMU KEY PRINCIPLE 11:**  
**CMU should promote liquid markets with efficient price formation**

Initial FESE Objective:	Achieve efficient price formation in well-regulated, liquid public markets and promote liquidity provision by market participants.
Current Situation:	While the recently agreed Investments Firm Review (IFR) clarifies that market making is a distinct activity, the overall approach needs to ensure that the cost of market making is not unnecessarily increased and the measurement of risks objectively takes into account the distinct and limited risk profile of these activities.
Outstanding Challenges:	To give the appropriate treatment to market makers recognising the limited risk of their activities.
FESE Recommendation:	Promote liquid markets by ensuring market makers can provide liquidity to the market without unnecessary regulatory burdens and cost in order to ensure efficient price formation and high liquidity, also in in SME shares.

The role of market makers has often been misunderstood by policy makers. Market-making is an activity that is fundamentally different from positional trading in terms of both complexity and the nature of the risk which is much lower. Usually market makers do not take significant positions over a long timeframe, but ideally provide liquidity on both sides of the markets to ensure a continuous and seamless price formation process in markets that would otherwise be less liquid.

Heterogeneous markets with multiple flow and liquidity providers ensure an efficient incorporation of all relevant information in the price formation process and ultimately result in lower spreads. Regulation that would increase the cost of market-making could lead to concentration which would induce systemic risks, should fewer participants remain active.

**FESE CMU KEY PRINCIPLE 12:**  
**CMU should ensure that market data issues are assessed holistically, with a focus on assessing the entire industry value chain and safeguarding price formation**

Initial FESE Objective:	Recognise the nature of Exchanges' business models within the overall industry market data value chain.
Current Situation:	Upcoming assessments of the impact of MIFID II on market data costs for industry participants.
Outstanding Challenges:	Balancing a focus on price and cost against the intrinsic value of market data across the industry.
FESE Recommendation:	Any assessment of market data costs and prices should cover the entire market data industry value chain, not simply Exchanges. Consideration should also be given to extending the MIFID II provisions to all relevant industry participants, notably data vendors.

An evaluation of MIFID II/MIFIR provisions on market data must be done with a full understanding of the following factors:

- The value of transparent markets;
- The investments involved in producing high quality market data and the commercial value derived from its exploitation;
- Overall market data costs and the market data value chain;
- Competition forces in the market data space.

Market data is the outcome of a dynamic price formation process and is a joint product together with trade execution. This legitimate business requires heavy IT investment and compliance infrastructures which must be able to generate some revenues. Exchanges recover cost through a combination of market data and trading execution fees<sup>46</sup>. On average, the revenue share of market data services was 31% in 2018 and has remained stable over the years.

Exchanges are part of a larger market data value chain including data vendors, software providers, IT and connectivity infrastructure. Exchanges' data revenues account for around 10% to 15 % of the total value chain<sup>47</sup>. Most importantly, the costs that market data represents to end-investors is very small, on average 0.003% of the total assets under management<sup>48</sup>.

Given the fact that Exchanges' business models have been impacted significantly by the MiFID framework, notably in terms of transaction fees, the price of market data has to be seen in the broader context of the overall costs of transacting and holding securities. This is crucial to ensuring consistency in line with the aims of CMU and the EU's desire to promote public capital markets financing. Impairing the commercial incentives to organise transparent markets will inevitably result in adverse consequences for investors, be they retail or professional, and beyond that the financing of the economy, economic growth and employment.

Attempts to impose price regulation in respect of market data and benchmarks would run counter to the rights businesses have, in a free-market economy, to define their fees based on the services they offer. It is therefore critical that the current regulatory and supervisory focus on market data costs does not pursue an overly narrow agenda which risks further undermining the ability of FESE members to fulfil its core function of financing the real economy.



**FESE CMU KEY PRINCIPLE 13:**

**CMU should allow benchmarks to serve the economy as already intended by current legislation**

Initial FESE Objective:	Recognise exchange’s business model and ensure that the benchmarks regulatory framework works as intended by the co-legislators.
Current Situation:	Benchmarks Regulation (BMR) and other ongoing legislative work-streams have been designed to bring the intended objective for well functioning markets, but interpretations create incoherence.
Outstanding Challenges:	Maintain a coherent approach.
FESE Recommendation:	Ensure a consistent approach across the different legislative files that impact the benchmark administration business by recognising regulated benchmarks’ ability to deliver on the CMU.

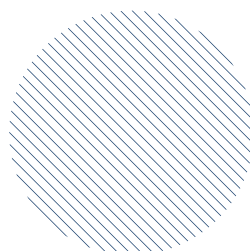
Exchanges provide a wide variety of benchmarks, including green, sustainable and social benchmarks. They promote geographical coverage, green segments and support innovation. Benchmarks are used to provide investment opportunities and serve as measures of economic performance. Providers of regulated data benchmarks ensure that there is a broad variety of (global) benchmarks enabling cost-efficient passive investment within the EU. Furthermore, regulated data benchmarks fulfil roles such as serving as information aggregates, reference values and benchmarks for financial instruments in global financial markets.

Delivering a sufficiently wide variety of benchmarks could be achieved by encompassing those issuers into targeted indices. The expected increased visibility would have the effect of improving liquidity in the longer run.

The Benchmarks Regulation (BMR) regulates the provision of European benchmarks, including

benchmarks based on regulated data and critical benchmarks (Libor, Euribor, Eonia and Stibor). While BMR became applicable on 1 January 2018, there is a transition period applying to many benchmarks until 1 January 2020. Benchmarks based on transaction data are subject to a specific regime for regulated data benchmarks which exempts them from a series of provisions since they are less susceptible to manipulation, while supervised and subject to comprehensive requirements, including under MiFID II/ MiFIR and MAR/MAD.

Policymakers should ensure a consistent approach across the different pieces of legislation that impact benchmarks in order to allow for a sound and efficient functioning of relevant areas that have a direct impact on the economy, growth and welfare in today’s EU. For instance, passive investment, ETFs, investment funds and most importantly pension funds.



## | 2.4 | Efficient Risk Management – Exchange-Traded Derivatives (ETDs)

Europe is home to some of the world’s largest and safest markets in ETDs. These markets operate well regulated, transparent, technologically advanced trading and clearing arrangements with a proven value proposition and track record in safety and reliability. The size of European derivatives markets is generally satisfactory when measured against the needs of the economy, however, a large portion of this activity takes place in the UK. Regulated derivatives Exchanges offer the highest standards of safety and integrity, as well as efficiency and competitiveness, in the trading of derivatives in a global marketplace, especially with Brexit in mind.

The EU should strive to maintain globally competitive European ETD markets. Capital markets regulation pertaining to ETDs needs to remain aligned with global standards as international coherence is important to avoid regulatory arbitrage and encourages global capital flows that support economic growth in Europe.

Vibrant derivatives markets can thrive in the EU, but this requires policy measures which adhere to global standards including:

- Reforming the position limits’ regime to ensure international alignment;
- Extending the EMIR clearing obligation to all standardised contracts;
- Removing open access provisions in Europe which would only undermine the stability and liquidity of these markets.

**FESE CMU KEY PRINCIPLE 14:**  
**CMU should support a position limits’ regime that allows new products to flourish**

Initial FESE Objective:	Support orderly pricing and settlement conditions and prevent market abuse in commodity derivatives markets.
Current Situation:	Overly burdensome requirements that hinder innovation and risk contracts moving OTC and to other jurisdictions.
Outstanding Challenges:	Ensure EU position limits regime does not hinder development and growth of new products and does not encourage exchange traded products moving to the OTC space or to other jurisdictions.
FESE Recommendation:	Promote international consistency and ensure a more proportionate regime regarding position limits requirements.

While the regulatory framework for position limits<sup>49</sup> is covered in MiFID II, there is a need for consistency globally which should allow for a more proportionate regime to help foster innovation. There are discrepancies between EU rules and rules in other jurisdictions that may be disadvantaging EU Exchanges. For example, in the US, only benchmark products are included in the position limit regime, while the EU regime covers all commodity derivatives traded on EU trading venues and Economically Equivalent

OTC (EEOTC) contracts. The EU rules are particularly problematic for niche and new products, products that are traditionally traded OTC and products with a limited number of participants.

Coupled with the absence of a trading obligation in respect of commodity derivatives, the rather loose definition of EEOTC, as well as the cumbersome reporting requirements, there is a risk of contracts moving from EU trading venues into the OTC space and to other jurisdictions. The EU position limits regime

may thus hinder the development and growth of new products, as well as the on-venue trading of commodity derivatives, in the EU.

The European Commission should consider refinements to relevant EU legislation to ensure consistency with

international standards following appropriate and ongoing evaluation and impact assessments (e.g. continued 'Call for evidence' process).

**FESE CMU KEY PRINCIPLE 15:**  
**CMU should support an extension of the EMIR clearing obligation to all standardised derivatives contracts**

Initial FESE Objective:	Implement G20 objectives; ensure all standardised derivatives are centrally cleared and traded on electronic platforms; increase transparency of derivatives markets.
Current Situation:	Potential loopholes and incentives to move derivatives contracts OTC.
Outstanding Challenges:	Ensure all standardised derivatives are subject to the clearing obligation for OTC derivatives.
FESE Recommendation:	Extend the EMIR clearing obligation to all standardised contracts, in particular standardised equity derivatives.

Responding to the financial crisis, at the 2009 Pittsburgh meeting, G20 leaders agreed to improve transparency of OTC derivatives, and agreed that standardised OTC derivative contracts should be centrally cleared through CCPs and traded on electronic platforms, by 2012. Central clearing for OTC derivatives was mandated in the EU via EMIR and adopted in 2012.

However, 10 years since the financial crisis, the clearing and trading mandates for OTC derivatives have not yet been fully implemented in the EU, with some categories of counterparties still being exempt. In addition, the obligations only apply in respect of certain interest rate and credit OTC derivatives. Since the trading obligation for OTC derivatives (mandated by MiFIR) is linked to the clearing obligation for OTC derivatives (mandated by EMIR), only those OTC derivatives subject to the clearing obligation can be realistically subject to the trading obligation.

In contrast to the OTC space, all ETDs are automatically subject to central clearing (mandated by MiFIR), regardless of the counterparties involved

in the transaction and the asset class. While all derivatives traded on a regulated market are subject to an obligation to centrally clear, look-alike contracts traded OTC (i.e. those contracts that mimic the economic value of the ETDs but are traded OTC as defined in EMIR) are only subject to the requirement to clear if ESMA mandates the products for clearing. By extension, these contracts are also not subject to the trading obligation under MiFIR.

There is therefore a loophole in the interplay between the divergent clearing rules under EMIR for OTC derivatives and under MiFIR for ETDs and the trading obligation under MiFIR. This loophole creates incentives to move ETD volumes to OTC venues and to pure bilateral trading that is not centrally cleared. In addition, contracts that are traded bilaterally are also not subject to MiFIR transparency requirements or even certain reporting requirements.

In order to close this loophole, and ensure transparent and orderly markets, we would recommend extending the EMIR clearing obligation to all standardised contracts, in particular standardised equity derivatives.

**FESE CMU KEY PRINCIPLE 16:**

**CMU should support the removal of ETDs from MiFIR’s ‘non-discriminatory’ access provisions**

Initial FESE Objective:	Remove ETDs from the ‘non-discriminatory’ access provisions between CCPs and trading venues in MiFIR.
Current Situation:	Following expiry of the current transitional exemptions, risks related to financial stability and market integrity will arise as a result of ‘non-discriminatory’ ETD access.
Outstanding Challenges:	Ensure integrity of ETD markets by adhering to the integrated model of trading and clearing as is the standard in global markets.
FESE Recommendation:	Remove ETDs from the scope of the MiFIR ‘non-discriminatory’ access provisions.

MIFIR provides for ‘non-discriminatory’ access to clearing, specifically with provisions requiring “two-way” access between CCPs and trading venues in respect of transferable securities, money market instruments and exchange-traded derivatives (ETDs). That is, CCPs must provide access to all trading venues, and trading venues must provide access to all CCPs. Critically, the access provisions also require fungibility or margin offsets where multiple trading venues are clearing similar products at the same CCP. In addition, MIFIR requires entities with intellectual property rights in benchmarks (such as an equity index) to licence them on reasonable commercial terms to any trading venue and/or CCP which wishes to offer products based on the benchmark.

For ETDs these requirements would undermine the stability and liquidity of European derivative markets, for which there is no effective solution. ‘Non-discriminatory’ access for ETDs would create unresolvable issues for both trading venues and CCPs and introduce operational inefficiencies that could prove detrimental to financial stability as well as liquidity especially in times of stressed market conditions.

ETDs require specific maintenance adjustments which the CCP could no longer control or at least face some difficulties in controlling under ‘non-discriminatory’ access. Variation Margin requirements or close-out netting of positions can only happen in one CCP. Fragmented markets, with activities of market participants spread across different venues

with different controls and safeguards, will make the default management process more complex, time consuming and risky, as they add an additional channel of contagion across CCPs.

A transparent and resilient price discovery system for ETDs is crucial for financial markets as a whole, given that ETD markets serve as a benchmark (reference price) influencing the price of the underlying (bond, share) and also the OTC derivatives (non-exchange negotiated derivatives). However, breaking the links between the trading venues and its CCP would disrupt liquidity and the price discovery process of ETDs across different exchanges. The erosion of the price discovery process resulting in a less accurate reference price can ultimately lead to serious financial stability risks, such as the creation of asset bubbles or the inability of financial supervisors to set accurate capital requirements for market participants such as credit institutions.

This reasoning is confirmed and highlighted by the fact that all NCAs receiving requests from trading venues and CCPs for temporary exemptions from the ‘non-discriminatory’ access rules pursuant to Article 52 (2) MiFIR have been granted. In addition, the case study originally used by ESMA and the European Commission to illustrate that such provisions may potentially work has ceased to exist.

It is therefore critical that policymakers acknowledge the distinct characteristics of ETD contracts and review again whether an open access policy is desirable.



Post-Brexit capital markets require further consideration from Europe as to what type of capital market to construct and what its fundamental architecture should be. For efficient and liquid hedging and risk transfer markets, ‘non-discriminatory’ access provides no added value in that architecture – at least for ETDs. ‘Non-discriminatory’ access would impose a fragmented structure on EU exchange-traded derivatives markets, causing problems for price formation, oversight and systemic risk that cannot be adequately addressed.

A re-think of the MiFIR provisions on ‘non-discriminatory’ access to CCPs and trading venues is warranted. It is important that policymakers acknowledge the distinct characteristics of ETD contracts and review the trading and clearing of derivatives. Given that the

political and regulatory agenda is now more than ever determined to preserve and further enhance the stability of financial markets, central clearing has become even more important for the evolution of the post-trading landscape in the EU as well as globally. Brexit also underlines the need to ensure effective supervision of financial markets infrastructures and enforcement of rules across jurisdictions.

Given that MiFIR ‘non-discriminatory’ access provisions for ETDs are not workable, contradict CCPs mandate to manage risks and impair Exchanges’ ability to foster liquidity in ETDs, FESE is calling on EU policymakers to consider Level 1 amendments to remove ETDs from the scope of open access provisions in MiFIR (Article 35 – 38 MiFIR).

## | 2.5 | New Technologies

New technologies can have a huge impact on capital markets, fostering consumers participation and facilitating access to funding for companies<sup>50</sup>. While technological developments should be embraced, it is also important to ensure a level playing field and to safeguard investors’ protection. The European Commission has proposed specific regulations on crowdfunding licensing regimes and developed a Fintech Action Plan presenting, among other initiatives, a blueprint with best practices on regulatory sandboxes.

### FESE CMU KEY PRINCIPLE 17:

**CMU should safeguard a playing level field of activities in the field of new technologies by applying the principle “same business, same rules”**

Initial FESE Objective:	Facilitate the possibility to develop and use new technologies as a driver to expand access to financial services for consumers, investors and companies. This would possibly bring greater choice and more user-friendly services, often at lower prices.
Current Situation:	The development of different technologies has accelerated in recent years and breakthroughs in one area reinforce progress in others.
Outstanding Challenges:	Existing legal and regulatory frameworks need to adapt to a fast-developing field and to evolve in order to ensure a level playing field of activities by applying the principle “same business, same rules”.
FESE Recommendation:	Apply a risk-based approach built on proportionality and materiality which allows for flexibility, particularly in respect of innovation with small groups of customers (i.e. sandboxes), while ensuring a level playing field across the EU; balance the local (country) risks alongside the benefits of cross-border markets (i.e. scalability, interoperability and passporting of services).

Technology has always been a source of structural change, as well as disruption, for financial markets, i.e. the rise of electronic trading or algorithmic trading. FinTech and RegTech have the potential to support the market to overcome certain barriers, while delivering efficiency gains and supporting risk mitigation. However, they could have ramifications throughout the whole lifecycle of securities on capital markets.

FinTech can help to expand access to financial services for consumers, investors and companies, bringing greater choice and more user-friendly services, often at lower prices. New financial technologies can help individuals as well as SMEs, including start-up and scale-up companies, to access alternative funding sources to support their cash flow and risk capital needs. Automation and standardisation have changed the way customers interact with market infrastructure providers, leading to an explosion in data volumes. Technological developments in relation to data analytics, Field Programmable Gate Array (FPGA), mobile technology, cloud computing, machine learning, artificial intelligence (AI) and blockchain are opening up new possibilities in relation to the services Exchanges use and provide to customers. Individually, these

technologies have enormous potential and combined, they can offer an impressive array of new solutions for clients.

Exchanges embrace the development of FinTech and the business opportunities it brings. European financial services regulation should cover new technology whilst ensuring it is applied carefully and allows efficiency gains. The principle of “same business, same rules” must be the driving force, since it is crucial to ensure a level playing field. Investors should be protected and for that policymakers should allow for a sandbox approach in the EU to make sure they understand the consequences of new technologies before they compete openly.

In an own initiative report, the ESMA Securities and Markets Stakeholders Group (SMSG) underlines the importance of legal certainty in Initial Coin Offering and crypto-Assets<sup>51</sup>. The report points to the need for clarification regarding the application of existing financial regulation to virtual assets. Such clarification is necessary given the very divergent national regulatory approaches to crypto-assets. This creates an unlevel playing field within the EU and hampers the creation of an internal market in this innovative field.

## DISTRIBUTED LEDGER TECHNOLOGY (DLT)

Combining innovative technologies, for instance blockchain based technologies, with established, highly regulated market infrastructures would be the natural choice in order to ensure market stability while making use of the innovative potential brought about through FinTech.

DLT has the potential to accelerate, decentralise, automate and standardise data-driven processes and therefore to alter the way in which assets are transferred and records are kept. In particular, DLT allows cross-verification of information in a transparent and dependable way and can simplify complex verification and validation processes.

Hurdles to wide scale adoption of DLT in securities markets are technical limitations, contextual aspects such as for example business model/market model design, technical integration/transition, legal/regulatory complexity.

For solutions based on DLT to reach actual implementation in securities market, visions for the future need to be broken down into defined descriptions of services and solutions that not only are accepted and desired by its intended consumers but also meet legal, regulatory and technical requirements. DLT is not a panacea that will replace all existing infrastructure in securities markets.

Recommendation: DLT solutions need to be integrated into the existing ecosystem of infrastructure in securities market, which will require some efforts and time. Transition planning and execution is also important in DLT business cases when the intention is for DLT to replace legacy technology.

An EU general regulatory framework needs to be geared towards fostering technological development and innovation. Technological developments are moving faster than the underlying legal and regulatory frameworks and in order not to impede innovation and investment, a rigid application of existing rules must be avoided. A predictable, consistent and straightforward legal environment should instead be promoted. Areas which would benefit from review include licensing requirement for FinTech companies, data protection, conflict of laws, outsourcing, cyber security, settlement finality and proper legal recognition of holding and transferring securities and other types of assets.

It is important to establish key principles upon which the EU can build a role in facilitating the development and implementation of FinTech.

These principles include the need for:

- The application of the same rules for the same services and risks (including across different pieces of legislation) based on the principle of technology neutrality;
- A risk-based approach built on proportionality and materiality which allows for flexibility, particularly in respect of innovation with small groups of customers (i.e. sandboxes), while ensuring a level playing field across the EU;
- A balancing of the local (country) risks alongside the benefits of cross-border markets (i.e. scalability, interoperability and passporting of services).

## | 2.6 | Sustainable Finance

We welcome and support the commitment by EU policy makers to find collective solutions to this global issue – specifically with the EC High-Level Expert Group on Sustainable Finance and the Action Plan on Financing Sustainable Growth. Given the urgent threat posed by climate change, capital markets have a crucial role to play in financing a future sustainable economy.

In the next years, regulators and industry need to collectively address the following questions:

- How can we ensure that sustainability is at the core of CMU 2024?
- Is sustainability a key differentiator of European capital markets? If so, how do we leverage on this?

**FESE CMU KEY PRINCIPLE 18:**  
**CMU should support Europe in mobilising sustainable finance**

FESE Objective:	In line with the Paris Agreement, the EU to take the lead in mobilising sustainable finance.
Current Situation:	The EU is a global leader in sustainable finance.
Outstanding Challenges:	Ensuring that a transparent, clear and consistent approach leads to agreement on what constitutes environmentally sustainable assets and activities.
FESE Recommendation:	Develop a long-term sustainable finance vision which ensures a level playing field between public and private markets, is built on a solid understanding of the role of financial markets and how these can facilitate the transition towards a low-carbon future and does not lead to unintended consequences for market players in terms of risk management.

When the previous edition of the FESE Blueprint was published, sustainable finance was not yet at the top of the EU political agenda. It is now a key priority as the EU is clearly becoming the global leader in this field<sup>52</sup>.

The European Commission published an Action Plan on sustainable finance that outlined future legislative and non-legislative actions. The Action Plan aims to: reorient capital flows to sustainable investments; manage financial risk related to climate change as well as environmental and social issues; and foster transparency by 2019. On 24 May 2018, the Commission published a series of legislative proposals, to:

- Create a taxonomy;
- Ensure that institutional investors disclose to what extent environmental, social and governance (ESG) factors are considered;
- Create new definitions for environmentally sustainable benchmarks; and
- Ensure that clients' sustainability preferences are taken into account.

In parallel to the legislative work, the Commission has also established expert groups to advise on the taxonomy, green bond standards, benchmarks and disclosures.

FESE welcomes and supports the commitment by EU policy makers to find collective solutions to address the urgent threat posed by climate change and considers that initiatives on sustainable finance can complement regulatory actions taken to fight climate change. A transparent and consistent approach in line with ESG aspects by the real economy, financial industry and regulators holds great opportunities for international capital markets, both in the area of risk assessment and for the identification of new business areas. A clearly defined taxonomy, whereby agreement on what constitutes environmentally sustainable assets is found, is a necessary starting point for other actions, such as standards and labels.

Within the proposed review of corporate reporting of non-financial information, any changes to the disclosure obligations on listed issues should be well-calibrated and proportionate. We would caution against increasing non-market-related disclosure obligations on listed issuers alone as this would risk

disincentivising companies from listing on public markets, which would not increase transparency.

Several measures could be taken to incentivise market agents towards longer-term orientation, including:

- Ensuring that accounting standards do not overly incentivise short-term behaviour and accommodate longer-term perspectives, which are important in respect of sustainable financing;
- Reassessing the range of factors needed to incentivise market participants in assessing longer-term risks.

Furthermore, it is important to always keep in mind that financial markets reflect developments in other parts of the economy. As such, the sustainable finance agenda cannot, by itself, realise the goals of the Paris Agreement. Real change can be achieved by adopting sector specific regulations and tax incentives to promote the fight against climate change. Such policies would have an impact on the companies' business models and either lead to a decline of certain businesses or a change of business strategy.

Any regulatory changes should not lead to unintended consequences in terms of risk management. Labels and standards which do not reflect market fundamentals can distort economic incentives and lead to a build-up of bubbles in the economy.

Ultimately, a shift in all economic agents' mind-set is the most crucial component of a successful transition to a low-carbon and resource-efficient economy that is geared towards inclusive growth and awareness of long-term risks.



## | 2.7 | Pursuit of global competitiveness and access

The EU should strive to maintain globally competitive European capital markets. A central element underpinning this objective is the equivalence mechanism. These mechanisms have a meaningful impact on FESE Members in areas such as shares and derivatives trading (forming the basis for third country venues to fulfil the MiFID II trading obligations) and ‘non-discriminatory’ access rights (under MiFIR) to name but two areas.

FESE therefore welcomes the ongoing reflection by EU policy makers on how the EU equivalence regimes and processes can be strengthened. Appropriate regulation and supervision of financial activities in a cross-border context has been a key regulatory objective against the background of the financial crisis, where a number of jurisdictions were adversely affected by developments outside their own jurisdiction. Now, with the full set of post-crisis financial markets regulatory reforms kicking-in, and regulation becoming ever more complex, it is important to highlight that the current EU equivalence processes and determinations need to be reformed to address identified shortcomings, such as transparency and predictability.

While there is a need to recognise that capital flows are global and that the EU financial markets should fit into a globally competitive model, any equivalence regime also needs to preserve stability and a level playing field between the EU and third countries. This overarching goal should not only be interpreted in terms of market access – but also in relation to the broader political objectives enshrined in EU legislation, such as investor protection, financial stability and the overall integrity and efficiency of markets.

FESE has already proposed a set of key guiding principles<sup>53</sup> that may be considered for the planned reforms of the EU’s equivalence regimes in different pieces of legislation. These principles aim to take a holistic and balanced approach, considering the interests of the EU, as well as third country jurisdictions, with the central goal of preserving market stability while also preserving open, competitive and global markets.

**FESE CMU KEY PRINCIPLE 19:**  
**CMU should ensure that an EU equivalence regime preserves market stability as well as open, competitive and global markets**

Initial FESE Objective:	While there is a need to recognise that capital flows are global and that the EU financial markets should fit into a globally competitive model, any equivalence regime also needs to preserve stability and a level playing field between the EU and third countries.
Current Situation:	Some elements of the equivalence regime have been reformed (e.g. in respect of third country investment firms under IFR).
Outstanding Challenges:	Future negotiations on the EU-UK relationship post Brexit will require a more holistic consideration of equivalence.
FESE Recommendation:	Build on the reforms already completed with a view to strengthening equivalence while recognising the differences between equity and derivative markets.

The overarching goal of equivalence should not only be interpreted in terms of market access – but also in relation to the broader political objectives enshrined in EU legislation, such as investor protection, financial stability and the overall integrity and efficiency of markets.

Equivalence decisions should not undermine the integrity of the Single Market nor financial stability in the EU. They should deliver a continuous level playing field and avoid a “race to the bottom” between the EU and third country jurisdictions.

Transparency of the decision-making process should be strengthened by ensuring the co-legislators’ (European Parliament and Council) involvement in accordance with the procedure for delegated acts. This would ensure that EU legislators gain clearly defined competencies, enabling them to maintain and promote their political and regulatory objectives and exert democratic control over the process. Industry should also be fully involved in the process as should the parties seeking equivalence, where relevant.

More granularity in the initial equivalence determinations undertaken by the European Commission should be introduced, especially as regards to systemically important jurisdictions and financial services.

Ongoing monitoring should be established by NCAs and ESAs to ensure equivalence is maintained, in terms of the rules and with respect to their enforcement and application. NCAs and ESAs should have clear responsibilities and resources to monitor how equivalence regimes may evolve to ensure that the overarching goals required in the relevant law are maintained.

Different approaches to equivalence may be warranted depending on the location of the third country, the characteristics of the trading relationship, the interconnectedness and integration of the markets, the systemic risks posed between the EU and the third country, as well as the type of financial services or activity, the type of product and the asset class, in question.

In all cases, major priority should be accorded to ensuring a level playing field with a focus on eliminating the potential for regulatory arbitrage arising from significant divergences in regulatory and supervisory approaches. Notwithstanding this, equivalence frameworks should also support and

promote policymakers’ commitment to support thriving EU financial markets and should not act to be so restrictive that they undermine their attractiveness and competitiveness in a global context.

Equities are intrinsically linked to EU companies’ funding and financing. Equivalence provisions should therefore require, on an initial and ongoing basis, tight regulatory and supervisory alignment of third country rules within the EU framework (in respect of jurisdictions which are of systemic importance to the EU and/or which have high levels of existing cross-border market integration).

Separately to equities, derivatives are predominantly global products; therefore, equivalence should be viewed very differently to ensure the market in a global setting remains effective. The regulation of derivatives and the thresholds for assessing the equivalence thereof, should remain aligned with global standards. International coherence is key to avoiding regulatory arbitrage and encouraging global capital flows which support economic growth in Europe.

Establishing an equivalence framework for derivatives which supports and promotes policymakers’ commitment to boost thriving EU financial markets and preserve their attractiveness and competitiveness in a global context is crucial.

Market participants use derivatives to hedge their risk where the exposure has the potential to extend out from months to decades. Which is why it is also essential that market access arrangements with third countries provide for stability and predictable outcomes, including the potential withdrawal of equivalence determinations. We therefore need to continue building on the reforms already completed with a view to strengthening equivalence while recognising the differences between equity and derivative markets.

**FESE CMU KEY PRINCIPLE 20:**

**CMU should ensure that EU equivalence rules do not unduly restrict market innovation and the ability to provide EU investors with access to global capital markets**

Initial FESE Objective:	A specific mechanism should be established with the aim of ensuring a level playing field for financial services providers based in the EU and the third country under consideration.
Current Situation:	Sometimes EU standards unintentionally may drive business an innovation outside of the EU.
Outstanding Challenges:	Monitor the alignment of regulation applying to the financial services sector of the EU, on the one hand, and the third country, on the other hand.
FESE Recommendation:	Criteria should be determined to govern ex-ante under which conditions this mechanism would be used and the process by which the decision to enable the mechanism would be taken.

The current EU concept of equivalence is based on an outcome-based approach to the assessment of third country regulatory regimes. In some areas, the equivalence framework recognises the possible diverse approaches to the implementation of international standards, whilst simultaneously ensuring that when market access arrangements are established, third country jurisdictions are appropriately regulated and have sufficient levels of supervision.

Different options for organising market access can be envisaged, ranging from a standard third country regime to an ad-hoc temporary arrangement. However, for all options, we believe that a specific mechanism should be established with the aim of ensuring a level playing field for financial services providers based in the EU and the third country under consideration.

Criteria should be determined to govern ex-ante under which conditions this mechanism would be used and the process by which the decision to enable the mechanism would be taken.

Under our proposals, this mechanism would, on a constant basis, monitor the alignment of regulation applying to the financial services sector of the EU, on the one hand, and the third country, on the other hand.

In addition, given that the industry’s level playing field and users’ protection can be undermined by differentiated application of otherwise identical rules, it would be crucial that the mechanism also monitors, on a constant basis, the implementation of regulation and practices.

Compared to current and standard arrangements for third country recognition and access to the EU financial market, this mechanism would need to go beyond a mere initial assessment of alignment of legislation and supervision. It would need to establish an ongoing dialogue between the ESAs, EU national regulators, third country financial regulators as well as EU and third country industry participants to focus on identifying cases of divergent regulatory and supervisory outcomes affecting the industry participants’ level playing field or users’ protection.

Should such a case of divergence in legislative, regulatory and supervisory outcomes be identified, a process with the relevant supervisory authorities should be triggered to restore the level playing field or the necessary safeguards. In the absence of an adequate remedy, market access could ultimately be restricted or suspended. Importantly, this mechanism should act swiftly and an efficient and time limited process for the identification, acknowledgement and resolution of cases would need to be designed. The mechanism should periodically inform the European Council and the European Parliament of its activities.

Unless a mechanism with the above features is put in place as a matter of priority, the EU financial industry providers and users may be faced with adverse consequences after Brexit, especially in case the EU and the UK do not conclude a withdrawal agreement.

## | 3 | OUR POLICY VISION

### Overall ambition and approach

#### KEY PRINCIPLES

*Capital Markets Union should*

1 > Be framed around a holistic regulatory agenda.

2 > Increase the overall size of EU public capital markets.

3 > Strengthen supervisory convergence while preserving the role and value of national competent authorities (NCAs).

4 > Remove fiscal disincentives against equity financing.

5 > Reject the adoption of transaction taxes given the detrimental impact this would have on public capital markets.

#### RECOMMENDATIONS

Integrate upcoming reviews of EU legislation (namely MiFID) into the CMU. Ensure that regulatory outcomes are aligned, and adopt a new approach aimed at improving and recalibrating the regulatory and supervisory framework where necessary, rather than introducing new regulation.

Reaffirm the goal of reaching a 100% stock market capitalisation of EU GDP by the end of the next legislative term (2024).

Ensure a streamlined interaction and proper allocation of roles between the European Supervisory Authorities (ESAs) and national regulators, prioritising strengthened supervisory convergence over the granting of direct supervisory powers to ESMA.

Review fiscal incentives against equity financing in Europe.

Avoid any measures that would disincentivise investing in capital markets.

### Funding the economy: serving investors and companies

#### KEY PRINCIPLES

*Capital Markets Union should*

6 > Support measures to foster financial literacy for both investors and entrepreneurs.

7 > Increase levels of retail investor participation in public capital markets.

#### RECOMMENDATIONS

Ensure public support and EU-wide initiatives to support Exchanges in their public good and educational activities.

Conduct a review on the impact of MiFID II's inducement rules on the way equities are distributed to investors and on research coverage of SME and mid-cap companies.



## KEY PRINCIPLES

*Capital Markets Union should*

8 > Increase levels of institutional investor participation in public capital markets.

9 > Support local ecosystems.

## RECOMMENDATIONS

Review equity capital charges under Solvency II and bring many of the smaller EU markets with listed companies on investors' radar screens.

- (i) Ensure coordinated developments of ecosystems;
- (ii) Embed proportionate regulatory frameworks;
- (iii) Consider the specificities of debt-only issuers; and
- (iv) Consider a single set of accounting rules for finance and taxation.

## Fair and orderly equity market structure

### KEY PRINCIPLES

*Capital Markets Union should*

10 > Support an increase in the proportion of price forming trading taking place on lit trading.

11 > Promote liquid markets with efficient price formation.

12 > Ensure that market data issues are assessed holistically, with a focus on assessing the entire industry value chain and safeguarding price formation.

13 > Allow benchmarks to serve the economy as already intended by current legislation.

### RECOMMENDATIONS

(i) Address any deficiencies in the application of the legislative framework as a matter of urgency so as not to risk unintended changes in market structure becoming permanently embedded;

(ii) Consider that capital markets with deep pools of high-quality liquidity are a crucial component of healthy ecosystems as well as an important contribution to competitive, transparent and stable EU financial markets.

Promote liquid markets by ensuring market makers can provide liquidity to the market without unnecessary regulatory burdens and cost in order to ensure efficient price formation and high liquidity also in in SME shares.

Any assessment of market data costs and prices should cover the entire market data industry value chain, not simply Exchanges. Consideration should also be given to extending the MIFID II provisions to all relevant industry participants, notably data vendors.

Ensure a consistent approach across the different legislative files that impact the benchmark administration business by recognising regulated benchmarks' ability to deliver on the CMU.

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## Efficient Risk Management – Exchange Traded Derivatives (ETDs)

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### KEY PRINCIPLES

*Capital Markets Union should*

14 > Support a position limits' regime that allows new products to flourish.

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### RECOMMENDATIONS

Promote international consistency and ensure a more proportionate regime regarding position limits requirements.

15 > Support an extension of the EMIR clearing obligation to all standardised derivatives contracts.

Extend the EMIR clearing obligation to all standardised contracts, in particular standardised equity derivatives.

16 > Support the removal of ETDs from the MiFIR's 'non-discriminatory' access provisions.

Remove ETDs from the scope of the MiFIR 'non-discriminatory' access provisions.

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## New Technologies

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### KEY PRINCIPLES

*Capital Markets Union should*

17 > Safeguard a level playing field of activities in the field of new technologies by applying the principle "same business, same rules".

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### RECOMMENDATIONS

Apply a risk-based approach built on proportionality and materiality which allows for flexibility, particularly in respect of innovation with small groups of customers (i.e. sandboxes), while ensuring a level playing field across the EU; balance the local (country) risks alongside the benefits of cross-border markets (i.e. scalability, interoperability and passporting of services).

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## Sustainable Finance

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### KEY PRINCIPLES

*Capital Markets Union should*

18 > Support Europe in mobilising sustainable finance.

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### RECOMMENDATIONS

Develop a long-term sustainable finance vision which ensures a level playing field between public and private markets, is built on a solid understanding of the role of financial markets and how these can facilitate the transition towards a low-carbon future and does not lead to unintended consequences for market players in terms of risk management.

## Pursuit of global competitiveness and access

### KEY PRINCIPLES

*Capital Markets Union should*

19 > Ensure that an EU equivalence regime preserves market stability as well as open, competitive and global markets.

20 > Ensure that EU equivalence rules do not unduly restrict market innovation and the ability to provide EU investors with access to global capital markets.

### RECOMMENDATIONS

Build on the reforms already completed with a view to strengthening equivalence while recognising the differences between equity and derivative markets.

Criteria should be determined to govern ex-ante under which conditions this mechanism would be used and the process by which the decision to enable the mechanism would be taken.



## | 4 | GLOSSARY

<b>AGI</b>	Allowance for growth and investment
<b>AI</b>	Artificial intelligence
<b>BMR</b>	Benchmarks regulation
<b>CCCTB</b>	Common consolidated corporate tax base
<b>CCP</b>	Central counterparty
<b>CESEE</b>	Central , Eastern and Southeastern Europe
<b>DLT</b>	Distributed ledger technology
<b>EEOTC</b>	Economically equivalent OTC
<b>EMIR</b>	European market infrastructure regulation
<b>ESAs</b>	European Supervisory Authorities
<b>ESG</b>	Environmental, social and governance
<b>ESMA</b>	European Securities and Markets Authority
<b>ETDs</b>	Exchange traded derivatives
<b>ETFs</b>	Exchange traded funds
<b>EU</b>	European Union
<b>FPGA</b>	Field programmable gate array
<b>FTT</b>	Financial transaction tax
<b>FX</b>	Foreign exchange derivative
<b>IFR</b>	Investment firm review
<b>IPOs</b>	Initial public offerings
<b>IRD</b>	Interest rate derivatives
<b>MAR</b>	Market abuse regulation
<b>MiFID</b>	Markets in financial instruments directive
<b>MiFIR</b>	Markets in financial instruments (MiFIR) – regulation
<b>MTFs</b>	Multilateral trading facilities
<b>NCA</b> s	National competent authorities
<b>OTC</b>	Over-the-counter
<b>RM</b>	Regulated markets
<b>SIs</b>	Systematic internalisers
<b>SMEs</b>	Small and Medium sized enterprises

## | 5 | DEFINITIONS

<b>Alternative Risk transfer markets</b>	The alternative risk transfer market is a portion of the insurance market that allows companies to purchase coverage and transfer risk without having to use traditional commercial insurance.
<b>Asset classes</b>	An asset class is a grouping of investments that have similar characteristics and are subject to the same laws and regulations. i.e. Equity, Bonds or derivatives.
<b>Benchmarks</b>	An index can be used as a benchmark to measure performance. Financial market participants use benchmarks to e.g. track the return of an investment, define portfolio assets or compute fees. Equity indices are often used to benchmark the performance of an economy. Big European indices include Euro Stoxx 50, CAC 40, DAX, OMX Stockholm 30, IBEX 35, FTSE 100.
<b>Blue chips</b>	Blue chips is used to define the largest stocks and/or issuers. They normally make up the main European indices.
<b>Bonds</b>	Bonds are financial instruments that allow public sector entities (i.e. governments, regional and local authorities, supra-nationals) or companies to raise funds by issuing debt without giving ownership rights. Bonds are a category of debt securities.
<b>Broker-Crossing Network (BCNs)</b>	BCNs are not formally defined in legislation but are generally understood to be computerised trading systems operated by investment firms away from trading venues. Firms operating BCNs typically use them to match combinations of in-house principal liquidity flows, client orders and electronic liquidity provider (ELP) flows. BCNs are prohibited under MiFID II.
<b>Brokers</b>	Brokers are agents who arrange a transaction between two parties, a buyer and a seller, charging a commission.
<b>Capital market ecosystems</b>	A network of institutions (such as small and mid-cap accountants, brokers, advisers, analysts, lawyers, etc.) which are needed to facilitate companies' access to finance at the local and regional levels.
<b>Capital markets</b>	Capital markets are the venues where savings and investments are channelled between the suppliers who have capital and those who are in need of it. In our terminology includes both public capital markets and private capital markets.
<b>Central counterparty or clearinghouse</b>	An entity that acts as an intermediary between trading counterparties and absorbs some of the settlement risk. In practice, the seller will sell the security to the central counterparty, which will simultaneously sell it on to the buyer (and vice versa). If one of the trading parties' defaults, the central counterparty absorbs the loss.
<b>Clearing and settlement</b>	Clearing is the process of establishing settlement positions, including the calculation of net positions, and the process of checking that securities, cash or both are available for the settlement of obligations. In other words, it is the process used for managing the risk of open positions. Settlement is the completion of a transaction or of processing with the aim of discharging participants' obligations through the transfer of money and/or securities.
<b>Commodity</b>	A commodity is good produced in bulk. Many commodities, such as coffee, meat and grain, and raw materials such as metals and oil, are traded on local, regional and/or international markets called commodity exchanges, either on a spot basis or through futures contracts, which allow the purchase or sale of a commodity at a predetermined price on a particular date in the future. In that meaning, it's a type of derivative contract.

<b>Dark Trading</b>	A form of equity trading where orders (prices and volumes) are hidden prior to execution. This may include trading on dark pools and over the counter (OTC).
<b>Debt financing</b>	When an issuer raises capital by selling bonds, bills, or notes to retail and/or institutional investors as well as bank lending. In return for lending the money, the individuals or institutions become creditors and receive a promise to repay principal and interest on the debt.
<b>Equity financing</b>	Companies raising funds by issuing shares.
<b>Equivalence regimes</b>	Process to assesses and decide that a country's regulatory, supervisory and enforcement regime is equivalent to the related EU framework. Once a market is deemed equivalent, services, products or activities can be provided or carried out in the EU. In some cases, equivalence may be required for EU participants to carry out certain activities in the third country.
<b>ESAs Review</b>	The ESAs Review refers to the proposed changes to the regulations establishing the three European Supervisory Authorities (EBA regulation, EIOPA regulation, ESMA regulation). Final agreement on the ESAs Review was reached in March 2019. The ESAs Review contains a range of measures to strengthen EU supervisory convergence.
<b>European market infrastructure regulation (EMIR)</b>	The regulation that introduced an obligation to centrally clear for OTC derivatives.
<b>Exchange traded derivatives</b>	An Exchange Traded Derivative (ETD) is a financial instrument that trades on a Regulated Market and whose value is based on the value of another asset. ETDs contract specifications are carefully crafted by Regulated Markets to be cleared through the CCP of that RM.
<b>Execution quality</b>	MiFID II obligates every execution venue to publish – on a quarterly basis – a report on the execution quality achieved.
<b>Financial instrument</b>	Contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.
<b>Financial literacy</b>	For an individual to have the knowledge to make informed and effective decisions regarding their finances.
<b>FinTech</b>	Financial technology used to describe new technologies that seek to improve an automate the delivery and use of financial services.
<b>Fixed income instrument</b>	An instrument that requires a fixed payment to the holder, usually with interest. Bonds are the most common form of fixed income.
<b>Indices</b>	An index is a measure of financial developments. An index can be used as a benchmark to for example measure performance. An equity index is determined based on the performance of a number of shares according to a formula.
<b>Inducement rules</b>	MiFID II contains a number of inducements requirements, including rules relating to conflicts of interest, research, hospitality, corporate access, and payment for order flow.
<b>Informed traders</b>	A trader trying to exploit private information through trading before it becomes publicly known.
<b>Initial and ongoing disclosure requirements</b>	Disclosure is the act of releasing all relevant company information that may influence an investment decision.
<b>Initial Public Offerings (IPOs)</b>	An Initial Public Offering (IPO) is the process by which the owners of a company sell shares in it to the public for the first time, joining the primary market via a stock exchange.

<b>Institutional investor</b>	Investors that invest their clients' money. Institutional investors include banks, insurance companies and pension funds.
<b>Instruments (equity, bonds and derivatives)</b>	Financial instruments are real or virtual documents entitling to asset ownership.
<b>Issuers</b>	An issuer is a legal entity that develops, registers and sells securities.
<b>Liquidity</b>	Liquidity describes the degree to which an asset or security can be quickly bought or sold in the market without affecting the asset's price.
<b>Listed instruments</b>	Listing means the admission of securities of a company to trading on a stock exchange.
<b>Listing Directive</b>	EU directive on the admission of securities to official stock exchange listing and on information to be published on those securities.
<b>Lit trading</b>	Lit trading is a form of equity trading where orders (prices and volumes) are visible prior to execution.
<b>Market Abuse Regulation (MAR)</b>	Regulates the integrity of securities markets and safeguards against market abuse. It aims to increase market integrity and investor protection, enhancing the attractiveness of securities markets for capital raising.
<b>Market maker</b>	A market maker is a firm that will buy and sell a particular security on a regular and continuous basis by posting or executing orders at a publicly quoted price. Article 48(2) and (3) MiFID II.
<b>Market Operators</b>	A firm responsible for a trading venue such as a Regulated Market.
<b>Markets in Financial Instruments Directive (MiFID)</b>	The Directive setting the basic legal framework for trading in financial markets in the EU.
<b>Markets in Financial Instruments Regulation (MiFIR)</b>	MiFIR is the regulation setting the basic legal framework for trading in financial markets in the EU.
<b>Multilateral and bilateral trading</b>	As a MiFID concept, multilateral trading is conducted through RMs and MTFs where multiple buyers and sellers are coming to the same pool of liquidity. It offers pre- and post-trade transparency of orders, has open and fair access, non-discriminatory execution and market surveillance. Bilateral trading is conducted only between two parties.
<b>Multilateral Trading Facilities (MTFs)</b>	One of the three categories of trading venue defined under MiFID II. According to Article 4(22), an MTF is a multilateral system, operated by an investment firm or a market operator, which brings together multiple third party buying and selling interests in financial instruments, in the system and in accordance with non-discretionary rules, in a way that results in a contract.
<b>Non-discretionary execution</b>	Non-conditional execution for which the trading venue has no discretion in determining how orders interact.
<b>'Non-discriminatory' access</b>	MiFIR requires 'non-discriminatory' access to clearing, which means that CCPs must provide access to all trading venues, and trading venues must provide access to all CCPs.
<b>Non-equity</b>	A non-equity option is a derivative contract for which the underlying assets are instruments other than equities. Typically, that means a stock index, physical commodity, or futures contract, but almost any asset is optionable in the over-the-counter market.
<b>Open &amp; fair access</b>	'Non-discriminatory' access to trading allowing asset prices to be driven by supply and demand.

<b>Over-the-counter (OTC)</b>	OTC trades include transactions which are non-systematic, ad-hoc, irregular and infrequent, are carried out between eligible or professional counterparties, and are part of a business relationship which is itself characterised by dealings above standard market size, and where the deals are carried out outside the systems usually used by the firm concerned for its business as a systematic internaliser.
<b>Position limits</b>	Limits to the positions that can be held in a commodity derivative (e.g. oil or wheat) contract. Position limits are intended to support liquidity, prevent market abuse and support orderly pricing and settlement conditions.
<b>Post-trade</b>	The obligation to publish orders and quotes of an instrument after the conclusion of the trade.
<b>Pre-trade</b>	The obligation to publish in real-time orders and quotes of an instrument.
<b>Price discovery</b>	Price discovery refers to the act of determining the proper price of a security, commodity, or good or service by studying market supply and demand and other factors associated with transactions.
<b>Price dissemination</b>	Prices get disseminated through the exchanges who offer the joint-product price formation and market data.
<b>Price formation</b>	The process of determining the price of an asset in the market place. Also known as price discovery.
<b>Primary issuance</b>	A primary issuance is the first issuance of stock or debt from a private company.
<b>Primary market</b>	The primary market (or listing) is the first stopover for companies to raise capital. When a company goes public, it gets listed in a RM. The primary market encompasses all the listed companies and provides issuers with access to a deep and diversified investor base consisting of both local, national and international investors.
<b>Proprietary trading</b>	Trading on own account rather than with the capital of external parties.
<b>Prospectus Regulation</b>	The Prospectus Regulation regulates the admission of securities to official exchange listing and clarifies the requirements to be published when securities are to be admitted to a Regulated Market or offered to the public.
<b>RegTech</b>	Regulatory technology created to address regulatory challenges in financial services through innovative technology.
<b>Regulated Data Benchmarks</b>	Benchmark that is based on transaction data from e.g. a trading venue such as an exchange. Under the Benchmarks Regulation, regulated data benchmarks benefit from a simplified legal framework compared to other types of benchmarks based on contributions that are more susceptible to manipulation.
<b>Regulated Markets (RMs)</b>	One of the three categories of trading venue defined under MiFID II. According to Article 4(21), an RM is a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments, in the system and in accordance with the RM's nondiscretionary rules, and in a way that results in a contract, in respect of the financial instruments admitted to trading under the RM's rules and/or systems. RMs are generally operated by traditional national stock exchanges.
<b>Regulatory sandboxes</b>	A regulatory sandbox is a framework set up by a regulator that allows FinTech start-ups and other innovators to conduct live experiments in a controlled environment under a regulator's supervision.
<b>Retail investor</b>	Individual investors invest that invest their own money through the use of an intermediary e.g. a bank. MiFID II distinguishes between retail and professional clients where retail clients enjoy higher consumer protection compared to professional clients and retail clients do not have access to all types of financial products.



<b>Secondary market</b>	The secondary market (or trading) is the second stopover for a company to improve its capital raising. It brings buyers and sellers together to trade stocks, bonds, derivatives, currencies, and any other financial instruments, by matching supply and demand of previously issued securities.
<b>Securities</b>	Securities are tradable financial assets.
<b>Small and Medium Sized Enterprises</b>	Article 4(1)(13) of MiFID II states that SMEs means companies that had an average market capitalisation of less than EUR 200.000.000 on the basis of end-year quotes for the previous three calendar years.
<b>SME Growth Market</b>	'SME growth market' is a concept introduced by the MiFID II Directive. An MTF can register for this providing it satisfies several conditions, including that, at the time the MTF is registered as an SME growth market and in any calendar year thereafter, at least 50% of the issuers whose financial instruments are admitted to trading on the MTF are SMEs.
<b>Systematic Internalisers (SIs)</b>	Defined under MiFID II as an investment firm that, on an organised, frequent systematic and substantial basis, deals on own account when executing client orders outside an RM, an MTF or an OTF without operating a multilateral system. The European Securities and Markets Authority (ESMA) is responsible for measuring the threshold for a 'frequent and systematic basis' to inform which investment firms qualify for the SI regime. SI activity must take place against the proprietary account of the operator (risk-facing) and generally does not include matching client orders against other client order or third-party liquidity.
<b>Tick sizes</b>	A tick size is the minimum price movement of a trading instrument. The price movements of different trading instruments vary, with their tick sizes representing the minimum amount they can move up or down on an exchange.
<b>Transfer of risk</b>	A risk management technique where risk shifts from one party to another. Risks may transfer between individuals and professional market participants.
<b>Transparency Directive</b>	The Transparency Directive requires issuers of securities traded on regulated markets within the EU to make their activities transparent, by regularly publishing certain information.
<b>Underlying asset</b>	An underlying asset is the financial asset upon which a derivative's price is based. Derivatives are contracts that derive their value from an underlying asset (e.g. equity, commodity or interest rate). The value of the derivative fluctuates with the price of the underlying asset.
<b>Uninformed traders</b>	A trader motivated to trade by a need to rebalance portfolios and smooth its consumption streams over time.

## | 6 | FOOTNOTES

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- 12 Maurice Obstfeld, "Risk-Taking, Global Diversification, and Growth," *The American Economic Review* 84 (1994): 1310–29, <https://doi.org/10.2307/2117774>; Niki Anderson et al., "A European Capital Markets Union: Implications for Growth and Stability," Bank of England Working Paper Series, 2015; Yuliya Demyanyk, Charlotte Ostergaard, and Bent E Sørensen, "Risk Sharing and Portfolio Allocation in EMU," 2008, <https://doi.org/10.2765/85145>; European Central Bank, "ECB Economic Bulletin, Issue 3 / 2018" (Frankfurt am Main, 2018); Fiorella De Fiore and Harald Uhlig, "Corporate Debt Structure and the Financial Crisis," *Journal of Money, Credit and Banking* 47, no. 8 (December 1, 2015): 1571–98, <https://doi.org/10.1111/jmcb.12284>; Bent E Sørensen and Oved Yosha, "International Risk Sharing and European Monetary Unification," *Journal of International Economics* 45 (1998): 211–38; Diego Valiante, "Europe's Untapped Capital Market Rethinking Financial Integration after the Crisis" (Brussels, 2016).
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- <sup>36</sup> European Commission, "Study on the Impact of MiFID II Rules on SME and Fixed Income Investment Research (FISMA/2017/117(06)/C)" (Brussels, 2017).
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- <sup>38</sup> See European Commission "Impact Assessment Accompanying the Document Proposal for a Regulation of the European Parliament and of the Council Amending Regulations (EU) No 596/2014 and (EU) 2017/1129 as Regards the Promotion of the Use of SME Growth Markets" (Brussels, 2018). See also AFME, "Capital Markets Union Measuring Progress and Planning for Success"; European Commission, "European Financial Stability and Integration Review 2018"; Xiaohui Gao, Jay R. Ritter, and Zhongyan Zhu, "Where Have All the IPOs Gone?," *Journal of Financial and Quantitative Analysis* 48, no. 06 (December 17, 2013): 1663–92, <https://doi.org/10.1017/S0022109014000015>; OECD, "OECD Business and Finance Outlook 2016: Chapter 4 -- Changing Business Models of Stock Exchanges and Stock Market Fragmentation" (Paris, 2016). on the decline in IPOs.
- <sup>39</sup> See also FESE "A Roadmap to Develop Smaller Capital Markets within the CMU" (Brussels, 2018).
- <sup>40</sup> This includes: Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, Slovenia, and the three Baltic countries.
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- <sup>43</sup> Oxera, "The Design of Equity Trading Markets in Europe." (London, 2019)
- <sup>44</sup> A tick size is the smallest amount by which a price can change.
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- <sup>47</sup> Oxera, "The Design of Equity Trading Markets in Europe." (London, 2019)
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- <sup>49</sup> A position limit is a pre-set level of ownership of derivative contracts that a trader may not exceed.
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