



## Savings and Sustainable Investment Union

The Next CMU High-Level Group

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Report to Ministers and presented to the Finnish Presidency

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## EXECUTIVE SUMMARY

The Next CMU High-Level Expert Group (“Next CMU Group”) is composed of high-level experts from Germany, France, the Netherlands, Italy, Spain, Poland and Sweden and reflects various parts of capital markets with public, private and academic experience. The task put by the Ministers to the Next CMU Group is to analyse, with a “fresh eye”, the EU’s market-based financing capacity five years after the launch of the Capital Markets Union (“CMU”) and to make appropriate recommendations. An initial approach was presented at the informal ECOFIN on the 13th of September 2019 at the invitation of the Finnish Presidency.

The overall feeling of the Next CMU Group is that, since the financial crisis, the financial sector has not yet fully regained citizens trust and that the purpose of the CMU project should be better articulated and more widely spread.

Accordingly, the Next CMU Group proposes a priority shift. From a first phase of the CMU that focused on revitalizing EUs’ capital market ecosystem, it recommends that the new phase gives priority to responses to citizens’ needs and to the investment in the real, digital and sustainable EU economy. People, sustainability and digitalization are the three priorities of the new European Commission.

Should political leaders of the three Institutions wish to widely signal such new orientation they could even consider changing the name of the CMU. This would make the purpose of such Union clearer for citizens and the wider economy. The Next CMU Group proposes the following new name: Savings and Sustainable Investment Union.

Within the current geopolitical, social and economic context, the Next CMU Group invites political leaders to focus on two EU major objectives:

1. **Adopting and promoting a capital market that offers saving products to serve citizens’ needs and that allocates capital to value creating investments in the real, innovating and sustainable economy.**
2. **Building/strengthening an integrated, competitive, deep and liquid European Capital Market, to maintain the EU as one of the top 2 financial centres of the world.**

To do so, the Next CMU Group has reached the conclusion that strong and determined political action on an EU and national level should focus on four capital market components, where significant progress can be achieved and drive the entire process to create a deeper and more robust capital market for the EU. The Next CMU Group unanimously recommends the Union to concentrate on the following four Absolute Priorities, for which twenty Transformational Recommendations have been identified, adopted as priorities that should guide any new initiative and/or be a test against which all decisions should be measured at political level:

1. **Generate more Long-Term Savings and Investment opportunities**
2. **Massively develop Equity Markets**
3. **Increase financial flow fluidity between EU financial market places**
4. **Develop Debt, Credit and Forex financing tools in a manner that increases the international funding currency role of the Euro**

The European Commission could even consider proposing to establish a Monitoring Steering Committee of interinstitutional nature in charge of setting concrete key performance indicators and expected outcomes and to periodically monitor progress and report.

### Transformational Recommendations:

#### Generate more Long-Term Savings and Investment opportunities

##### 1. Launch an adequacy-test for multi-pillar retirement savings.

Member States should set medium to long-term targets for achieving adequate pensions. These targets should be made public and progress towards these targets should be measured regularly against a common European methodology that can be used as an indicator in the European Semester.

##### 2. Strengthen measures to enable and incentivise savers to turn into investors.

Assisting private individuals and households in transforming from passive savers into more active investors should become a topic of highest priority for the Union. Investor protection, fair treatment and cost transparency rules should be consistently applied and enforced and consumers should have access to fair advice. The EU should further encourage collective ‘workplace savings’ and ‘employee shareholder plans’. Consider establishing a minimum harmonized tax incentive for general savings in simple and transparent long-term financial instruments like single shares and ETFs.

##### 3. Increase measurable and comparable Sustainable Investments.

Institutional investors and other financial market participants should take an active role in implementing the new EU Regulation on sustainable investment disclosures and commit to public reporting on clear objectives for their investment strategies. The European Commission, together with other interested parties, should utilise its leading role in sustainable finance to trigger the process of creating a set of high quality non-financial reporting standards with international reach to measure companies’ contribution to sustainable economic and social growth for which the governance of companies take responsibility.

##### 4. Develop a straightforward EU procedure for repayment of withholding taxes to investors.

The EU should establish a European harmonized procedure with one form to be used by all Member States and a maximum period in which a decision on a request for repayment must be made, after which the institutional investor concerned can resubmit its request to the European Commission, which may then mediate between the Member State and tax payer concerned.

## Massively develop Equity Markets

### 5. Accelerate private investments by directing public funding towards Venture Capital and Private Equity funds, and local fund of funds targeting midsize institutional investors.

The EU should increase the funding of Venture Capital and favour the emergence of large late-stage Private Equity funds. It should also boost ELTIF, EuVECA and EuSEF to develop pan European “UCITS like” vehicles for private assets.

### 6. Introduce the definition of a new category of experienced High Net Worth (“HNW”) investors with tailor made investor protection rules.

HNW investors could be defined as those that have sufficient experience and financial means to understand the risk attached to a more proportionate investor protection regime. The EU Commission should carry an impact assessment of the cumulative dis-incentivizing effect of investor protection provisions of several pieces of legislation (UCITS, MiFID, PRIIPs) on investors access to markets and suggest appropriate measures.

### 7. Significantly simplify access to the public markets for SMEs and Mid-Caps.

A revision of the SMEs definition adopted under MiFID to qualify an SME Growth Markets (“SME GM”) by raising the threshold from 200 million euros to 500 million euros, in line with other EU legislative measures (Growth Prospectus, ELTIF). Such a category of SMEs and Mid-Caps could also be granted special access to segments of Regulated Markets. To enable intermediaries and financial analysts to produce research on SMEs and Mid-Caps the research unbundling introduced with MiFID II could be exempted for such category of companies. Create a regulated market segment devoted to SME and Mid-Caps benefiting from an alleviated regulatory regime, 5 years after IPO. In addition, EU funds can be channelled to the IPO phase through private and/or public funding: EU structural, EIB or national public funds could be used to support listing of SMEs and Mid-Caps, notably through the creation of a ‘Cross Over IPO Fund’.

### 8. Strengthen incentives for institutional investors to hold more Equity by adapting the Solvency 2 regime and refining the IFRS 9 accounting standard.

### 9. Accelerate and set a calendar for the implementation of a European Electronic Access Point and extend it to companies listed on SMEs Growth Markets.

## Increase financial flow fluidity between EU financial market places

### 10. Allow the emergence of competitive pan-European and regional market players with critical mass, by supporting cross-border mergers and acquisitions in the financial sector.

Supporting cross-border mergers by rebalancing liquidity, capital restrictions and legal constraints without endangering the overall EU financial stability.

### 11. Review the Central Securities Depositories (“CSD”) Regulation.

Such revision should aim at facilitating more efficient cross border post trading services for issuers and investors. CSD Regulation should not reduce the ability of CSDs to offer collateral management, securities lending and borrowing services to market participants. Furthermore, the efficiency of CSDs should be improved by widening the scope of instruments they are allowed to use.

### 12. Establish a single market data Consolidated Tape.

The European Commission should specify criteria for a single Consolidated Tape covering all execution venues in a delegated act based on MiFID II. The consolidated tape should be non-profit, fall under the responsibility of ESMA and may as a first step cover equity post-trade data.

### 13. Avoid supervisory competition through a strong and coherent EU supervisory framework,

which progressively allocates the supervision function at different layers with respect to the level of market integration, every time a Directive or Regulation is reviewed. Start by providing ESMA with direct or compulsory indirect supervision function on EU-significant equity trading and post trading venues.

### 14. Reassess the regulatory and supervisory balance.

Reduce overreliance on prescriptive and detailed rules and compensate that by more consistent and rigorous supervision and enforcement. This could also be obtained by a more principle based approach in the level 1 legislation and by a reduction of national transposition options and more extensive use of Regulations (MiFID).

### 15. Reinforce effectiveness of insolvency regimes across the EU.

Continue the harmonization effort as defined by the European Commission. Pursue the harmonization of insolvency regimes applicable to credit institutions and in parallel, complement the Statute for European Company with a specific chapter on Insolvency.

### 16. Elaborate an ambitious EU wide Digital Finance Action Plan.

Such an Action Plan should capture the inherent cross-border dimension of digital finance which calls for establishing a European Sandbox and strengthening an Innovation Hub Program, for screening of EU legislation for digital readiness and, for ensuring consumer and investor trust with respect to data protection and cyber security. The aim should be a competitive, secure, fair and innovative European digital single financial market, with ESMA granted with a compulsory convergence role in this area.



### Develop Debt, Credit and Forex financing tools in a manner that increases the international funding currency role of the Euro

#### 17. Create the conditions to establish the euro as a reference asset currency.

Member States, Institutions and market participants should create conditions to develop a common market for reference assets for the euro area that truly meet the criteria for reference assets. The euro area lacks a euro area-wide benchmark yield curve.

#### 18. Establish Sovereign Green Bonds as a flagship product for EU's capital markets.

The issuance of Green Bonds by Member States has a significant signalling effect to the capital market and should become an integral part of their funding strategy. Member States with significant activity on the debt market should have issued a Green Bond and agreed common standards for budgeting and reporting requirements by 2021.

#### 19. Revitalise securitization markets.

A deep and well-functioning securitisation market that can recover strongly from the lows of 2013/14 is an essential element of a dynamic capital market and for euro area lending, including for SMEs. Where possible the regulatory and supervisory framework for STS Regulation should be accelerated and when reviewed, a key task will be to ensure that regulation is neutral between securitization and similar instruments like covered bonds. In view of such a revision the revitalisation of the securitizations market should be closely monitored.

#### 20. Ensure an efficient and competitive pan-European payment market.

Europe already has a highly efficient and secure payment infrastructure. Digital innovations and global trends have moved the demand for retail instant payment services into focus. To avoid fragmentation of the payment market, pan-European solutions should be decisively supported. Instant payments as a new payment infrastructure within the Single Euro Payments Area (SEPA) can play a major role.



Vogelschwarm (Kuhreiher), KfW-Bildarchiv / Bernhard Schurian, Brasil, December 2012

## INTRODUCTION

The Next CMU High-Level Expert Group (“Next CMU Group”) is composed of high-level experts from Germany, France, the Netherlands, Italy, Spain, Poland and Sweden and reflects various parts of capital markets with public, private and academic experience. The task put by the Ministers to the Next CMU Group is to analyse, with a “fresh eye”, the EU’s market-based financing capacity five years after the launch of the Capital Markets Union (“CMU”) and to make appropriate recommendations<sup>1</sup>. An initial approach was presented at the informal ECOFIN on the 13<sup>th</sup> of September 2019 at the invitation of the Finnish Presidency.

This report is not a call to revisit recently adopted legislation as all legal instruments should first be implemented and they contain review clauses that allow reconsideration in due course after thorough study by the European Commission. In addition, the Next CMU Group has not interfered with the negotiations relating to the UK leaving the European Union (Brexit). Conclusions and recommendations of this report are in full consistency with the Banking Union and the Economic and Monetary Union.

Recommendations aim at strengthening the global competitiveness and attractiveness of EU financial markets in their ability to finance, in a self-sufficient and open manner, the EU economy, its growth and its job creation.

The Next CMU Group has worked in an inclusive and fully transparent manner. It has widely consulted interested parties and has received numerous contributions and responses to its online questionnaire<sup>2</sup> and profited from research already done by think tanks and others<sup>3</sup>. During its deliberations, it has always been guided by an EU vision and the mutual interest of Member States. It has neither been influenced by any specific political or market player interest nor by competition between EU financial centres.

A first conclusion is that the rationale behind the launching of the CMU is still very valid (reduction of internal cross border barriers, diversification of financing sources and complement to the Banking Union) but progress to date has not yet produced sufficient tangible results in the market, although the Commission has been quite successful in driving the legislative agenda<sup>4</sup> and the European Parliament clearly set out its priorities in several resolutions<sup>5</sup>.

1 <https://nextcmu.eu>

2 See Annex 3

3 A particular mention has to go to “Rebranding Capital Markets Union: A market finance action plan”, CEPS-ECMI Task Force Report: Karel Lannoo and Apostolos Thomadakis, Centre for European Policy Studies, Brussels, June 2019

4 European Commission contribution to the European Council in Sibiu, Romania, 9 May 2019: “Capital Markets Union: progress on building a Single Market for capital for a strong Economic and Monetary Union”, 15 March 2019, plus accompanying Staff working paper, which can be found on: [https://ec.europa.eu/info/publications/190315-cmu-progress-report\\_en](https://ec.europa.eu/info/publications/190315-cmu-progress-report_en)

5 The most important resolutions are:

- 2015 - [http://www.europarl.europa.eu/doceo/document/TA-8-2015-0268\\_EN.pdf](http://www.europarl.europa.eu/doceo/document/TA-8-2015-0268_EN.pdf) on Building a Capital Markets Union
- 2016 - [http://www.europarl.europa.eu/doceo/document/TA-8-2016-0006\\_EN.pdf](http://www.europarl.europa.eu/doceo/document/TA-8-2016-0006_EN.pdf) on Stocktaking and challenges of the EU Financial Services Regulation
- 2016 - [http://www.europarl.europa.eu/doceo/document/TA-8-2016-0358\\_EN.pdf](http://www.europarl.europa.eu/doceo/document/TA-8-2016-0358_EN.pdf) on Access to finance for SME’s and increasing the diversity of SME funding in a Capital Markets Union
- 2018 - [http://www.europarl.europa.eu/doceo/document/TA-8-2018-0215\\_EN.pdf](http://www.europarl.europa.eu/doceo/document/TA-8-2018-0215_EN.pdf) on Sustainable Finance

A second conclusion is that since 2015, geo-political, social and economic developments, including concerns about a slowdown of growth, create a vivid sense of urgency, reinforced further by an expected Brexit. As a minimum, the following trends should be highlighted:

- **Shock absorption capacity:**

The EU needs more risk sharing mechanisms through the financial markets to increase its asymmetric shock absorption capacity. Furthermore, a paradigm shift in trade relations may lead to long run uncertainty about market access and further threats to stability,

- **Digital Finance:**

Digitalization, Artificial Intelligence and Blockchain technology are disrupting established business models more rapidly than expected and trigger significant opportunities to create pan-European access to finance and to improve efficiency,

- **Aging population and inadequate saving structure:**

According to the EC's 2018 Pension adequacy report<sup>6</sup>, with the observed demographic evolution, based on current pension policies, 18% of older people in the EU remain at risk of poverty or social exclusion. In addition, citizens' savings are held in short term financial savings products which creates a predictable mismatch with their long term saving needs.

- **A more diversified funding system to support citizens' and companies' needs:**

First phase of CMU was very much focused on revitalizing an ecosystem damaged by the crisis and on alleviating banks' balance sheets. This new phase should be more 'purpose' oriented. A genuine EU capital market (made of domestic ecosystems and cross border activity) should improve returns on long-term savings for EU citizens through a wider range of investment products; provide more diversified funding options for the real economy, SMEs and innovative companies, through private and public equity; and unleash the potential of institutional investors in addressing financing sustainable growth,

- **Sustainability:**

Climate change awareness is rapidly modifying behaviours in society and the financial sector can be a powerful transformational tool,

- **Competitiveness of the EU financial sector:**

Removing cross border barriers and encouraging consolidation of EU market players will increase their competitiveness and their market share,

- **Brexit:**

A major international financial centre (including an advanced equity market) which is the global hub for EU market financing is expected to leave the Union. Some activity and talent will be transferred and spread over several financial centres however it will also translate into losses of capacity which will need to be rebuilt by the EU 27 to maintain its ranking and full capacity.

Within this new context, the Next CMU Group unanimously invites EU Institutions political leaders to focus on two EU major objectives:

1. **Adopting and promoting a capital market that offers saving products to serve citizens' needs and that allocates capital to value creating investments in the real, innovating and sustainable economy.**
2. **Building/strengthening an integrated, competitive, deep and liquid EU Capital Market, to maintain the EU as one of the top two financial centres of the world.**

Various analysis and numerous consultations carried by the Next CMU Group lead to the conclusion that deep pools of liquidity allowing better capital allocation exist where there is both significant long-term savings and a sophisticated and dynamic equity market. Multiple other market segments and a diverse ecosystem prosper where such market realities are present. All other major economies and financial centres benefit from these two structural features. The EU 27 capital market will be spread over several market places and with such fragmentation, there is a risk that the EU Capital market is not perceived as a single pool of liquidity. In addition, as in other economies with large capital markets, a broad use of a funding currency in international capital markets contributes to depth and liquidity.

Recent reports from the IMF<sup>7</sup> and AFME<sup>8</sup> contain interesting material on relative strong points of the capital markets of individual Member States. The report "Unlocking the Growth Potential in European Capital Markets" of think tank New Financial<sup>9</sup> takes this one step forward in demonstrating how much benefits could be gained if all Member States would perform as good as the present top five per identified strong points. Indeed these reports do not only legitimize further action at the EU level, but also make evident that there still is a lot to be gained by appropriate reforms at the national level as well.

The Next CMU Group has reached the conclusion that strong and determined political action on an EU and national level should focus on the following four capital market components, where significant progress can be achieved and drive the entire process to create a deeper and more robust capital market for the EU:

1. **Generate more Long-Term Savings and Investment opportunities**
2. **Massively develop Equity Markets**
3. **Increase financial flow fluidity between EU financial market places**
4. **Develop Debt, Credit and Forex financing tools in a manner that increases the international funding currency role of the Euro**

Accordingly, the Next CMU Group unanimously recommends that the EU concentrates on the above mentioned four Absolute Priorities during the new phase of the CMU and that they are adopted as priorities that should guide any new initiative and/or be a test against which all decisions should be measured at political level. Policies not in accordance with these Absolute Priorities should be reconsidered before final decision.

This report is articulated around each Absolute Priority, for which the Next CMU Group proposes specific recommendations with real transformational effect. In addition, it has identified several areas where key objectives and indicators could be developed to periodically measure progress.

<sup>7</sup> IMF discussion note: A Capital Market Union for Europe; SDN/19/07, September 2019, para 39, page 13

<sup>8</sup> AFME, Capital Markets Union. Measuring progress and planning for success, September 2018, in particular Appendix 1 and 2, pages 42 and 43. (Update for 2019 expected)

<sup>9</sup> New Financial; Report: Unlocking the Growth Potential in European Capital Markets; by Panagiotis, Asimakopoulos & William Wright, June 2019.



## Chapter 1

# GENERATE MORE LONG-TERM SAVINGS AND INVESTMENT OPPORTUNITIES

### Why

To provide citizens with adequate opportunities for planning and saving for their long-term financial needs, in particular pension savings, is one of the key social and economic roles of capital markets. This creates long-term available capital to finance economic growth notably to facilitate the transition towards a more sustainable economy and to provide long-term equity financing for companies and SMEs. Long-term savings are therefore a key component of an efficient EU capital market. The Next CMU Group recommends that building and proposing long-term market-lead responses to citizens' needs becomes an Absolute Priority for the second phase of the CMU for the following reasons:

- Citizens' retirement and saving needs.** The demographic evolution of EU citizens, translates into an aging population and the ratio between active workers and those in retirement will deteriorate substantially. In addition, given the current low interest rate environment, investing in capital markets across a range of assets over the long-term generates higher returns than keeping savings in a traditional bank account. Multi-pillar retirement savings could provide citizens with a better future income during retirement. This includes retirement savings via additional capital based occupational pensions, and/or individual pension products. Citizens save for other life goals as well. However, EU investors overall participation in capital markets is relatively low. Data on EU household

financial assets show that there is significant potential for increased participation of retail investors in EU capital markets<sup>1</sup>. There is a clear need for better, cheaper and simpler investment products. Financial literacy is either not available or not as detailed and informative as citizens would need it to be aware of risks and diversification opportunities or pre-digested savings products, and of working distribution chains for cost efficiency.

- Financing Sustainable growth and SMEs.** Reaching a climate neutral economy requires significant investments in long-term projects that will produce benefits only after a long transition period. Investors with sufficient available long-term capital have a direct interest to do so. Similarly, innovative Start-ups or SMEs need investors that accompany them in the long run through long-term equity financing.
- Alleviating Public Finance.** Citizens' long-term pension savings can significantly reduce the future economic burden of pension provisions on taxpayers and governments' budgets under pay-as-you-go pension systems. In addition, market based financing energy transition investments and other investment towards a sustainable economy will complement public spending that will not be sufficient.

<sup>1</sup> See ESMA, 2019: report on performance and cost of retail investment products in the EU,



## Transformational recommendations to generate more long-term savings and investment opportunities

### 1. Adequacy-test for multi-pillar retirement savings

The way Member States organise their pension system is fundamentally a social and political choice. However, differences between Member States make clear that some Member States do considerably better than others<sup>2</sup>. Reaching an adequate pensions level for citizens is much more important than which system may or may not be appropriate in any given Member State. Accordingly, the Next CMU Group recommends that Member States should set long-term targets for achieving adequate pensions<sup>3</sup>. These targets should be made public and progress towards them should be measured regularly along a common European methodology that can be used as an indicator in the European Semester<sup>4</sup>. In as far as collective or individual capital based pension saving will be part of national pension systems, a KPI could be included to be measured in the context of the development of a full CMU.

In general, multi-pillar pension systems where, on top of a statutory pay-as-you-go pension, workers are automatically enrolled in capital based additional pension arrangements, with or without an opt-out<sup>5</sup>, score best. This can be complemented by third pillar individual retirement savings, preferably capital based, as these provide better long-term returns compared to bank savings. Voluntary individual pensions help to cater for personal preferences and choice for better coverage and can complement the first and second pillar. A pay-as-you-go first pillar pension

depends on future economic developments and is less vulnerable to financial shocks. A capital based additional second pillar is more effective in coping with ageing.

Substantial progress could therefore be made at the national level, if Member States were to commit to certain objectives and would agree for progress to be clearly and regularly assessed, and publicly discussed in the Council and in the European Parliament. Reinforcing the European Semester could establish a framework for this.

It also is recommended to analyse which tax incentives work best within each specific Member State context and to combine such information with data on pension adequacy available from the triannual pension adequacy reports of the European Commission. Member States would then be asked to report on the effectiveness of their own systems and incentives. The Structural Reform Support Service of the European Commission can assist Member States to reform their pension systems.

In short, depending on the national context, mandating auto-enrolment, collective bargaining as well as tax and financial incentives, including cost-effective access for different groups, are all options for the development of supplementary pensions and retirement savings<sup>6</sup>. Workplace related pensions and savings opportunities fit well with the long-term nature of retirement savings as well as they prepare for post-retirement pension income.

The European Commission has set up a High-Level Group of Experts on Pensions<sup>7</sup> which is working on recommendations to make better use of occupational pensions. The report of the HLGE on Pensions is expected at the end of this year. The European Insurance and Occupational

Pensions Authority (“EIOPA”) is working on a new Defined Contribution Blueprint for occupational pensions that may help tailor pension solutions to individual Member State situations. Increased participation in occupational pension schemes can become a substantial catalyst for creating new demands for long-term investments in equity.

For citizens to save and invest for retirement by themselves, they should have an easy access information about their personal situation from the public first pillar pensions and the second pillar occupational pensions. In some Member States, efficient web based pension tracking systems have been established to provide actual individual information. The European Commission supports a project to set up a voluntary European Tracking System<sup>8</sup>. Should that not be already the case, Member States should ensure that a national pension tracking system is setup and that such system can be connected to a EU wide tracking system.

In Member States where the occupational pension sector is less developed, the Pan-European Personal Pension Product (“PEPP”) may provide an alternative tool for the retirement savings of mobile European citizens. PEPP offers a simple, transparent and standardized product with features that enable comparability across products. In addition, such standardized features bring economies of scale and efficiency gains to firms that provide PEPP. The PEPP regulation allows for the active use of digital solutions. This been said, the success of the PEPP is heavily dependent on the content of the forthcoming implementing measures.

### 2. Strengthen measures to enable and incentivise savers to turn into investors

Assisting private individuals and households in transforming from passive savers into more active investors, thereby increasing the opportunities for improved long-term financial planning should become a higher priority for the Union. Commission, ESAs, Members States and national supervisors should continue to share best practices and significantly strengthen their efforts to increase access Surveys, including the Eurobarometer analysis, show that investor confidence in financial markets remains relatively low<sup>9</sup>. A 2018 study of the Commission on the distribution systems of retail investment products highlighted the limited availability of ETFs for retail investors and found that in each Member State, non-independent advisors at banks and insurance companies almost exclusively proposed in-house products<sup>10</sup>. Conversely, third party products were proposed only in rare cases. Costs associated with obtaining financial products are important, in the current low interest environment. In addition, due to a variety of disclosure rules applying, including on costs, it is not always clear to investors how different products compare to each other<sup>11</sup>.

<sup>2</sup> See Melbourne Mercer Global Pension Index 2018.

<sup>3</sup> Principle 15 of the European Pillar of Social Rights: “Workers and the self-employed in retirement have the right to a pension commensurate to their contributions and ensuring an adequate income. Women and men shall have equal opportunities to acquire pension rights. Everyone in old age has the right to resources that ensure living in dignity.”

<sup>4</sup> A legal base to develop the necessary indicators may be found in the proposal for a Council recommendation on access to social protection for workers and the self-employed, on which the EPSCO Council reached a political agreement in December last year. The European Commission and the Social Protection Committee will under para 20 of the recommendation be tasked to “develop agreed common quantitative and qualitative indicators to assess the implementation” of the recommendation.

<sup>5</sup> In the UK the introduction of auto-enrolment with an opt-out, starting from larger companies and low premiums, going to smaller companies and somewhat higher premiums, has achieved results in relatively limited time, demonstrating that a well-designed scheme of workplace pensions can take-up quicker than often assumed.

<sup>6</sup> The 2018 Pension Adequacy report, EC, p.18

<sup>7</sup> <https://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupID=3589&news=1>

<sup>8</sup> <https://www.findyourpension.eu/en/ets/>

<sup>9</sup> Eurobarometer (2016), Financial Products and Services <<https://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Survey/getSurveyDetail/yearFrom/1974/yearTo/2016/surveyKy/2108>>, n.446. See also the previous Eurobarometer (2012), Financial Products and Services, n.373.’

<sup>10</sup> In January 2019, ESMA published its first annual statistical report on costs and performance of retail investment products, which contains valuable information and suggestions for improvement.

Incentives and robust investor protection for retail investor include:

- Transparency on costs, performance and fees: As indicated by European Securities Markets Authority (“ESMA”) in its study on the performance and cost of retail investment products in the EU<sup>11</sup>, currently there are differences in the EU regulatory frameworks applied to different products and due to national discretions. Further cross-legislation and cross-country consistency would also provide major benefits in terms of data availability, especially if paired with machine readability,
- A minimum harmonized tax incentive for general savings in simple and transparent long-term financial instruments like single shares and ETF’s. A minimum amount of yearly savings, in absolute and or relative terms, could be set at the EU level. Building of experience in several Members States, a possible common tax treatment could be “TEE”<sup>12</sup> therefore amounts saved after taxes if paid into such an account should not be taxed on capital gains or on withdrawal. Such a Simple European Tax incentive could be opened for PEPP as well, in Member States where no other tax incentive for PEPP exists,
- Enhancing the investment ability of retail investors also includes the availability of sufficient and easily digestible information about investment opportunities, in formats which are accessible generically on hand-held devices. The focus should be on enabling retail investors to participate by actively raising knowledge, rather than passively restricting access. The cumulative effect of the investor protection provisions of several pieces of legislation creates a disincentive for retail investors due to excessive complexity (UCITS/ MiFID/PRIIPS),
- Fair advice: Retail investors would benefit from access to affordable and independent advice, breaking conflicts of interest across the distribution chain. The current dual regime of ‘independent advice’ (where inducements are banned) and ‘non-independent advice’ (where inducements are allowed subject to conditions) has so far insufficiently promoted more independent and objective advice and should be reviewed,

- Promote financial literacy: Managing both risks and opportunities in one’s personal finances should be a basic part of each EU 27 Member State school curriculum. In case it falls on commercial parties to provide this kind of efforts, the development of a European quality benchmark should be considered.

Citizens have more reasons to save for long-term objectives than retirement. Collective ‘workplace savings’ and ‘employee shareholder plans’ are financial products that allow employees to participate in and benefit from the growth of the company they work for and can produce long term returns. It also helps companies creating employees’ incentives and stabilising their equity capital. The EU should facilitate further the use of such investment vehicles for employees of cross border groups.

### 3. Long-term financing of sustainable economic growth

Through the capital markets institutional investors with large scale investment capacity can contribute to sustainable economic growth by taking more long-term and higher-end risk investments.

#### a. EU role in measurable and comparable Sustainable Investments

Long-term investment strategies make institutional investors the key players in responsible investing. A practical EU-wide taxonomy should be completed as soon as possible followed by an effort to encourage international convergence.

In March 2019 the European Parliament and the Member States reached a political agreement on a proposal for a Regulation on sustainable investment disclosure rules. This Regulation sets out how financial market participants and financial advisors must integrate environmental, social or governance (ESG) risks and opportunities in their processes, as part of their duty to act in the best interest of clients. The Regulation also requires the disclosure of adverse impact on ESG matters, such as in assets that pollute water or devastate bio-diversity, to ensure the sustainability of investments. They should also

take a pro-active role in shaping and implementing ambitious ESG disclosures that will help them define strategies for investing towards a sustainable economy. Practical but accurate methodologies for this type of disclosures still have to be further developed. Institutional investors should take an active role in this, and commit to clear public objectives and reporting for their own investment strategies.

This would also be the case with availability of comparable data from companies in which investors invest. At present obligations are put on investors to provide information but companies do not provide standardised information to investors. There is a real willingness of companies, supervisors, non-financial rating agencies and audit firms to respond to such investors need. Several uncoordinated initiatives are taking place globally. Whilst positive, this has not yet created reliable and comparable quality information for which the governance of companies takes responsibility. The European Commission should take benefit from its leading role in sustainable finance to trigger the process of elaborating with interested parties a set of high quality non-financial reporting standards with international reach to measure companies’ contribution to sustainable economic and social growth.

#### b. Role of EIB and national promotional banks in supporting long term investments

Large institutional investors face less liquidity restrictions to invest than the public and/or banking sector. Infrastructure projects are often developed in the form of public private partnerships (PPPs). These projects are developed with elements of public support by Member States, the European Union, European Investment Bank (“EIB”)/ European Investment Fund / “EIF” or national promotional banks.

By setting up the EIAH (“European Investment Advisory Hub”<sup>13</sup>) and the EIPP (“European Investment Project Portal”<sup>14</sup>) together with the EIB, the Commission provides technical support to national, regional and local authorities to structure such kind of projects.

The EIB/EIF, national promotional banks and the Commission operate several programs to create funds or other vehicles that should allow institutional investors to participate in markets that are either still carrying too much risk, entail entry to less well-known markets, or involve a large group of small investments that on their own are difficult to assess, but taken together provide risk-return combinations. If well designed, and with a focus on crowding-in private institutional investors<sup>15</sup>, these schemes may contribute to further long-term investments.

#### c. A European procedure for repayment of withholding taxes to investors

Cross-border investments suffer from inadequate withholding tax regimes. Procedures for repayment are cumbersome, costly and sometimes unpredictable. Mutual agreement procedures between Member States are too slow and do not necessarily lead to adequate and fair outcomes. In practice the size of this problem is very different from Member State to Member States. The result is that inefficient withholding tax procedures inhibit inward investments from institutional investors in other Member States.

The Commission has already identified such obstacle in the CMU Action Plan and is working on a guideline based on best practices, but this should be reinforced with a European harmonized procedure with one form to be used by all Member States and a maximum period in which a decision on a request for repayment has to be made, after which the institutional investor concerned can resubmit its request to the European Commission, after which the Commission may mediate between the Member State and tax payer concerned. To ensure the matter stays high in the agenda, the Commission should be asked to periodically report about progress towards fair and quick procedures. The Commission could also be asked to study the technical viability of withholding tax procedures based on blockchain technology.

11 ESMA, 2019, Report on performance of cost of retail investment products in the EU, [https://www.esma.europa.eu/sites/default/files/library/esma50-165-731-asr-performance\\_and\\_costs\\_of\\_retail\\_investments\\_products\\_in\\_the\\_eu.pdf](https://www.esma.europa.eu/sites/default/files/library/esma50-165-731-asr-performance_and_costs_of_retail_investments_products_in_the_eu.pdf)

12 Taxed-Exempt-Exempt

13 <https://eiah.eib.org>

14 <https://ec.europa.eu/eipp/desktop/en/index.html>

15 See for a critical analysis with a view to the risk of crowding-out, the recent special report no 03/2019: European Fund for Strategic Investments: Action needed to make EFSI a full success, of the European Court of Auditors

## Transformational recommendations:

### 1. Launch an adequacy-test for multi-pillar retirement savings.

Member States should set medium to long-term targets for achieving adequate pensions. These targets should be made public and progress towards these targets should be measured regularly against a common European methodology that can be used as an indicator in the European Semester.

### 2. Strengthen measures to enable and incentivise savers to turn into investors.

Assisting private individuals and households in transforming from passive savers into more active investors should become a topic of highest priority for the Union. Investor protection, fair treatment and cost transparency rules should be consistently applied and enforced and consumers should have access to fair advice. The EU should further encourage collective 'workplace savings' and 'employee shareholder plans'. Consider establishing a minimum harmonized tax incentive for general savings in simple and transparent long-term financial instruments like single shares and ETFs.

### 3. Increase measurable and comparable Sustainable Investments.

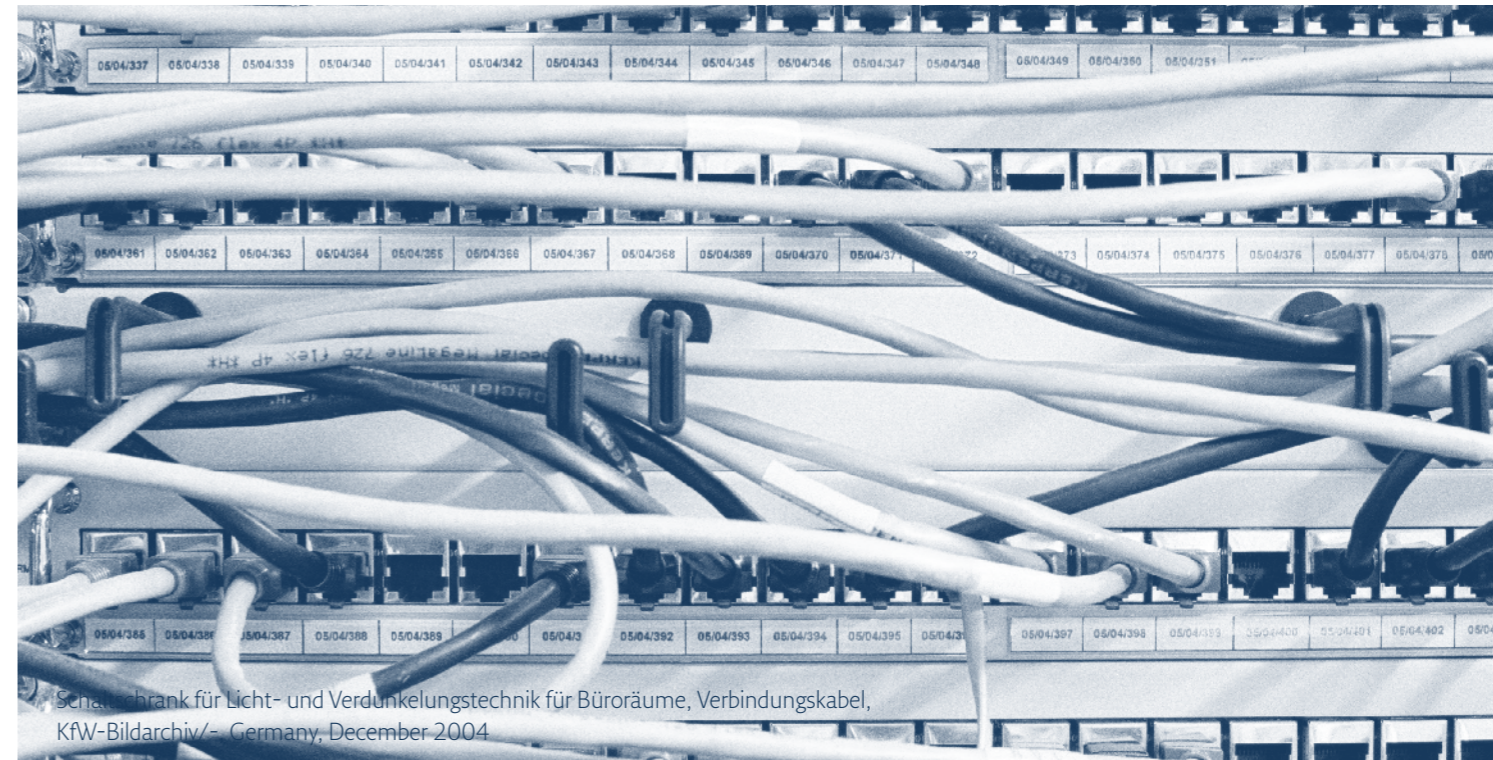
Institutional investors and other financial market participants should take an active role in implementing the new EU Regulation on sustainable investment disclosures and commit to public reporting on clear objectives for their investment strategies. The European Commission, together with other interested parties, should utilise its leading role in sustainable finance to trigger the process of creating a set of high quality non-financial reporting standards with international reach to measure companies' contribution to sustainable economic and social growth for which the governance of companies take responsibility.

### 4. Develop a straightforward EU procedure for repayment of withholding taxes to investors.

The EU should establish a European harmonized procedure with one form to be used by all Member States and a maximum period in which a decision on a request for repayment must be made, after which the institutional investor concerned can resubmit its request to the European Commission, which may then mediate between the Member State and tax payer concerned.

## Chapter 2

# DEVELOP MASSIVELY EQUITY MARKETS



Schneidersbank für Licht- und Verdunkelungstechnik für Büroräume, Verbindungskabel, KfW-Bildarchiv/- Germany, December 2004

## Why

Value creation financing in a more intangible economy highlights the need for corresponding high levels of capital. In the EU, additional market-based financing is needed to provide long-term growth capital to companies and notably for the financing of start-up and to scale-up

businesses. Evidence shows that the EU should build a deep and liquid capacity for both private and public equity markets, even more after Brexit. To be competitive, the EU Equity Market ecosystem should be more flexible and responsive to support companies through different growth phases.

To mainly develop Equity Markets in the EU, the Next CMU Group recommends to: (i) Accelerate the development of EU Venture Capital and Private Equity markets (ii) Simplify SMEs and Mid-Caps access to the public markets; (iii) Strengthen equity holding by institutional investors; and (iv) Revitalise the EU Equity Market ecosystem to allow simpler cross border investments and access to the EU pool of liquidity.

## 1. Accelerate the development of EU Venture Capital and Private Equity markets

### a) Strengthen the EU's Venture Capital marketplace

The availability of venture capital is a critical factor for technological competitiveness, future growth and attractive employment opportunities. Venture capitalists typically take an active role in the start-ups and scale-ups they invest in, and provide important help and coaching to founding entrepreneurs, sometimes also opening new markets to them and regularly raising ambitions. Venture capital thrives in ecosystems that open talent pools like research institutions and universities and enable talented people to become successful entrepreneurs. Despite positive development since 2012 the EU is lagging far behind the strong US Venture Capital market.

### Measures to accelerate the development of EU's Venture Capital include:

- **Increase the availability of funding for Venture Capital investments and develop larger late-stage Venture Capital funds above €1bn.**

Analysis shows that the insufficient size of the EU's Venture Capital market is not only a symptom but also a cause. Additional capital could trigger positive and self-reinforcing effects. More Venture Capital leads to larger funds and correspondingly enables larger financing rounds. In addition to further professionalization, this also makes the asset class increasingly attractive for institutional investors with higher minimum required investment amounts sizes. At the same time, more capital can lead to more successful

exits. The EU is missing larger late-stage funds able to finance scale-ups growth in rounds above €30M<sup>1</sup>. Most of these companies are currently financed by US Venture Capital.

- **Accelerate private investments by directing public funding towards large funds, and local fund of funds targeting midsize institutional investors.**

The EIF and NPIs public investments supporting Venture Capital favors the emergence of large pan-European funds. Without neglecting local ecosystems and the general development of the Venture Capital companies, NPIs should support emerging late-stage Private Equity funds. For mid-size investors, fund of funds could be an easier diversified entry mode. NPIs and EIF could play a role in the emergence of a diversified offer for new investors, allocating part of their investments.

- **Increase transparency and reduce fragmentation within the European VC markets.**

Attracting investors towards the Venture Capital asset class requires a reliable basis for investment decisions based on the transparency of performance and risks. In addition, fragmentation along national lines limits the ability of EU Venture Capital funds to utilize economies of scale. A harmonization based on transparency national best practice should be pursued.

- **Tax obstacles.**

The European Commission has published a best practice report on various national tax incentives as part of CMU. These findings should be pursued further and, if necessary, extended to other areas (e.g. Venture Capital investment schemes).

For a self-sustaining Venture Capital and Private Equity markets, a high-quality potential deal flow and viable exit routes are needed. Successful exits are usually accomplished via trade sale or Initial Public Offering ("IPO"). Trade sale is currently the most widely used exit channel, while IPOs are less frequent. Both channels need to be strengthened. Regarding trade sales, strategic industrial investors should be encouraged to be even more open for

acquiring young, Venture Capital backed companies. Liquidity to absorb IPOs from technology companies increases the likelihood of IPOs.

Creating larger Venture Capital funds would indirectly improve the liquidity of the market, since larger funds enable firms to scale-up more and demonstrate their potential ahead of an IPO. In general, more publicity about successful exits would also help to raise awareness about potential options for exits. IPOs are supported by the assessments made by financial analysts. However, there is often a lack of coverage of young Venture Capital backed companies (pre- and post IPO). This lack of expertise makes these companies' shares more volatile. Conditions to enable young enterprises to have a successful IPO should be further analyzed. Regional differences in a highly fragmented EU stock market landscape exist. A corresponding benchmarking study could be commissioned on this topic.

### b) Boost ELTIF, EuVECA and EuSEF to develop pan European "UCITS like" vehicles for private assets

EU Undertakings for Collective investment in Transferable Securities ("UCITS") is a well-recognized international standard for liquid funds. For illiquid funds, the EU labels European Long-Term Investment Funds ("ELTIF"), European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) lack similar recognition, both inside and outside the EU. These labeled vehicles were also created for small asset managers to avoid complying with the full set of Alternative Investment Fund Managers Directive ("AIFMD") rules and benefit from a European passport. Under Solvency 2 such labeled funds benefit from a favorable capital treatment (22% vs 49% for Private Equity funds).

The success of the EuVECA varies across Member States and is further developing thanks to the 2017 legislative modification extending its use to larger asset managers and allowing Mid-Caps as eligible assets. This said, despite its merits, the Venture Capital and Private Equity industry still make a limited use of this label. The use of ELTIFs is progressively starting to be used with various ELTIFs launched with private debt, infrastructure or even private equity assets. Those ELTIFs target retail or institutional

investors but not the two combined.

ELTIF has the potential of becoming a "UCITS like"- success for qualified investors to access to illiquid assets. The following measures would improve its capacity to serve as an efficient vehicle to invest in the real economy:

- Promote ELTIF merits more widely to asset managers and institutional investors,
- Favour cross-border retail investing by simplifying the notification and marketing registration and clarifying how ELTIF fits with the Markets in Financial Instruments Directive (MiFID) II applicable rules to semi-professional investors (for example by lowering the €500K threshold to €100K),
- Supervisors should clarify further the guidance on real assets,
- Review the cross-border tax treatment of ELTIF to avoiding double taxation<sup>2</sup>.

## 2. Significantly simplify access to the public markets for SMEs and Mid-Caps

Of the listed firms across the EU, only 20% are large blue-chip companies associated with exchanges and major indexes. In fact, in numbers, most of the listed companies belong to the Mid- or Small-Cap segments. These non-blue-chip companies account for only some 10% of the trading volumes and are those who struggle with the current public markets regulatory framework. Capital markets policy efforts should therefore be primarily focused on supporting the companies below the Large-Cap segment, at the IPO stage as well as during their listed life.

### The following measures will favour IPOs of SMEs and Mid-Caps:

- **The definition of a new category of experienced High Net Worth ("HNW")** investors with tailor made investor protection rules. Experienced HNW investors could be defined as those that have sufficient experience and financial means to understand the risks of a more proportionate investor protection,

<sup>1</sup> In France, the "Tibi Report" sets the ambition of reaching 10 funds above €1bn in the next 3 years: [https://minefi.hosting.augure.com/Augure\\_Minefi/r/ContenuEnLigne/Download?id=40C3DA75-8DAB-4300-86D1-C7ED87BD9045&filename=1351%20-%20Rapport%20Tibi%20-%20FR.pdf](https://minefi.hosting.augure.com/Augure_Minefi/r/ContenuEnLigne/Download?id=40C3DA75-8DAB-4300-86D1-C7ED87BD9045&filename=1351%20-%20Rapport%20Tibi%20-%20FR.pdf)

<sup>2</sup> Due to inconsistencies of the AIFMD with the Base Erosion and Profit Shifting (BEPS).

- **A revision of the SMEs definition adopted** under MiFID to qualify an SME Growth Markets (“SME GM”) by raising the threshold from 200 million euros to 500 million euros, in line with other EU legislative measures (Growth Prospectus, ELTIF). Such category of SMEs and Mid-Caps (“SMEs and Mid-Caps”) could also be granted special access to segments of regulated markets,
- **To enable intermediaries and financial analysts to continue to produce research on SMEs and Mid-Caps** the research unbundling introduced with MiFID II could be exempted for such category of companies,
- **Channel EU funds to the IPO phase through private and/or public funding.** EU structural, EIB or national public funds could be used to support listing of SMEs and Mid-Caps, notably through the creation of a ‘Cross Over IPO Fund’. Closer and visible cooperation between public and private funding can lead to anchor investors showing willingness to invest. The Horizon Europe program<sup>3</sup> and the activities by the European Innovation Council<sup>4</sup> are supporting many companies across Europe. Many companies supported by this program have already led to IPOs. This can develop further to support innovative companies on the IPO route.

More specifically, the Next CMU Group recommends simplifying access to both the newly created concept of SME Growth Markets (“SME GM”) and the regulated markets. Next CMU Group also recommend that SME GM status could be granted to a special segment of a regulated market.

*a) Further develop SME Growth Markets and create more cross-border capital flows*

Today, only a few Members States have developed SME GM with many SMEs shares listed benefiting from sufficient liquidity. To complement loan financing and the private capital financing available for SMEs, and to provide an important exit route for Private Equity, developing SME GM should become a priority. Developing more numer-

ous, possibly interconnected, and liquid SME GMs within the EU will favour SMEs shares trading and give intermediaries opportunities to offer simple and geographically diversified investment products such as ETFs and equity mutual funds.

#### Proposed measures include:

- **Simpler process for launching an SME GM** without the need to set-up a separate entity when created by a market operator already running a regulated market,
- **Simplify Market Abuse and Prospectus applicable rules.** The basic assumption is that due to their size or age, companies listed on an SME GM should not apply the same rules than senior, Large-Caps listed on the top regulated market segment. Currently, Market Abuse and Prospectus apply to all companies irrespective of their size and listing/trading venue, with only minor simplifications introduced for an SME GM. This approach does not consider the disproportionate burdens for smaller companies different from large and established ones. The Next CMU group believes that further proportionality can be introduced whilst maintaining a high level of investor protection by making:
- **The Market Abuse Regulation (“MAR”) regime simpler,** especially to prevent diverging interpretations across markets and borders. For example, certain MAR provisions can be waived to avoid companies listed on a SME GM being overburdened by insider lists and some internal dealing disclosures requirements,
- **Prospectuses easily digestible for investors and cost-efficient to produce for companies.** It means that the content of the prospectus for SME GM companies should be radically reviewed and made proportionate.

*b) Encouraging SMEs and Mid-Caps to list on regulated markets*

To encourage SMEs and Mid-Caps to list on regulated market, like the US Jobs Act, some rules could be alleviated for the first five years after listing. The EU applicable rules to companies admitted to trading on a regulated market (i.e. Transparency Directive, Shareholders Rights Directive, Takeover Bids Directive, Accounting Directives and the Prospectus Regulation) should be screened to identify the provisions for which such temporary alleviation should apply.

### 3. Strengthen incentives for institutional investors to hold more Equity

Additional institutional investors equity investments would favour a deeper and liquid EU capital market, especially for SMEs and Mid-Caps. Given the size and the long-term characteristics of institutional investors, they are well suited to manage the risk which relating to SME investments.

Accordingly, to remove disincentives to institutional investors equity holding, the Next CMU Group recommends rebalancing the following regulatory provisions:

- **An adapted Solvency 2 framework:** Pensions funds and insurers are the two main financing sources for long term investments, including equity financing, for both Digital and Sustainable transition. Solvency 2 that has provided a stronger risk based economic framework for insurers will be reviewed in 2020. It is a fact that since Solvency 2 is applicable, insurers have reduced their equity portfolios. The Next CMU Group recommends that within the context of such review specific attention is paid to the Solvency 2 procyclicality unintended effect that pushes insurers to sell risky assets at crisis time, making equity the adjustment factor, and to other disincentives to invest in the real economy. In a context of low interest rates, neutralizing Insurers disincentives to invest in equity should be part of a balanced revision of Solvency 2 capital requirements not leading to an increase or decrease of the overall capital charge nor translating

into more procyclicality. This includes considering a 22% equity holding category defined in accordance with long-term liabilities or other long-term investment strategies (5-years) measured at portfolio level.

- **Accounting rules:** An unintended impact of IFRS 9 could be an equity investment decrease due to Profit & Loss (“P&L”) volatility notably for Property & Casualty Insurers and Life Insurers (for some of their liabilities). To favour long-term investment whilst preserving transparency and the need for a global standard, based on the recent European Financial Reporting Advisory Group (“EFRAG”) review, the Next CMU Group recommends the International Accounting Standards Board (“IASB”), as a practical way forward, to reintroduce a fair value through “Other Comprehensive Income” for equities with a recycling to P&L of realized capital gains/losses, combined with a robust ruled-based impairment model. IASB should also include in the definition of equities direct holdings, ETFs and Equity Mutual Funds.

Lastly, the EU should avoid imposing requirements to listed companies exclusively. For Instance, ESG objectives should have a broader scope, irrespective of whether the company is public or private. If not, such measures risk being interpreted as raising the public markets entry barrier.

### 4. Measures to facilitate cross border investments and access to the EU pool of liquidity

Facilitating EU wide market access to both investors and companies will increase long term investment opportunities and geographical diversification for retail investors. It will make EU’s capital markets more fluid and the pool of liquidity larger. Facilitating measures include:

- **Open language regimes to a wider use of English.** Costs for providing a prospectus in lesser used languages can be disproportionate, which disincentives new and smaller issuers to enter the public markets

<sup>3</sup> [https://ec.europa.eu/info/horizon-europe-next-research-and-innovation-framework-programme\\_en](https://ec.europa.eu/info/horizon-europe-next-research-and-innovation-framework-programme_en)

<sup>4</sup> [https://ec.europa.eu/commission/news/european-innovation-council-2019-mar-18\\_en](https://ec.europa.eu/commission/news/european-innovation-council-2019-mar-18_en)

and reduces investor choice. Member States and/or National Competent Authorities (“NCA’s”) should consider accepting a prospectus written in English<sup>5</sup>.

- **Central information point.**

Accelerate the European Electronic Access Point (“EEAP”) project under the Transparency Directive. To reach the same US EDGAR system benefits in the EU, the EEAP activities and funding should be stepped up. Additional IT investments are needed to ensure efficient access to company reporting across the EU and favour pan European investor interest. Such EU-wide facilities should be expanded to information disclosed by SMEs companies listed on SME GM.

- **Shareholders rights.**

Exercising Shareholders rights across borders can be made easier by using blockchain solutions.

- **Securities holdings regimes.**

Differences in the setup of account structures and securities holdings regimes continue to create barriers for cross-border investments. A more EU harmonised structure should be introduced, such as: (i) implementing the book-entry principle across EU, (ii) specify the role and responsibilities of account providers and (iii) introduce a consistent regulatory framework on the segregation of client securities accounts.

## 5. Further build EU’s Equity Market ecosystem

To develop an efficient equity capital market and support Large-Caps as well as SMEs and Mid-caps businesses, EU’s regulatory framework should favour its capital markets ecosystem.

A well-functioning Equity Market ecosystem must have: (i) a variety of investors with diverse investment strategies (Business angels, Venture Capital, Private Equity, institutional, local and international as well as retail investors), (ii) efficient market professionals (Investment banks, brokers, asset managers, advisors, financial analysts), and (iii) specialised and complementary venues for listing and trading able to provide multiple capital raising options for companies and exit opportunities for investors.

## Transformational recommendations:

### 5. Accelerate private investments by directing public funding towards Venture Capital and Private Equity funds, and local fund of funds targeting midsize institutional investors.

The EU should increase the funding of Venture Capital and favour the emergence of large late-stage Private Equity funds. It should also boost ELTIF, EuVECA and EuSEF to develop pan European “UCITS like” vehicles for private assets.

### 6. Introduce the definition of a new category of experienced High Net Worth (“HNW”) investors with tailor made investor protection rules.

HNW investors could be defined as those that have sufficient experience and financial means to understand the risk attached to a more proportionate investor protection regime. The EU Commission should carry an impact assessment of the cumulative dis-incentivizing effect of investor protection provisions of several pieces of legislation (UCITS, MiFID, PRIIPs) on investors access to markets and suggest appropriate measures.

### 7. Significantly simplify access to the public markets for SMEs and Mid-Caps.

A revision of the SMEs definition adopted under MiFID to qualify an SME Growth Markets (“SME GM”) by raising the threshold from 200 million euros to 500 million euros, in line with other EU legislative measures (Growth Prospectus, ELTIF). Such a category of SMEs and Mid-Caps could also be granted special access to segments of Regulated Markets. To enable intermediaries and financial analysts to produce research on SMEs and Mid-Caps the research unbundling introduced with MiFID II could be exempted for such category of companies. Create a regulated market segment devoted to SME and Mid-Caps benefiting from an alleviated regulatory regime, 5 years after IPO. In addition, EU funds can be channelled to the IPO phase through private and/or public funding: EU structural, EIB or national public funds could be used to support listing of SMEs and Mid-Caps, notably through the creation of a ‘Cross Over IPO Fund’.

### 8. Strengthen incentives for institutional investors to hold more Equity

by adapting the Solvency 2 regime and refining the IFRS 9 accounting standard.

### 9. Accelerate and set a calendar for the implementation of a European Electronic Access Point and extend it to companies listed on SMEs Growth Markets.

<sup>5</sup> An example is the language regime applicable in the Netherlands : <https://www.afm.nl/en/professionals/veelgestelde-vragen/aanbieding-notering-effecten-algemeen/taal-prospectus>



Klimaanlage an der Fassade eines Wohnhauses, KfW-Bildarchiv / photothek.net, Tunisia, Dezember 2012

### Chapter 3

## INCREASE FINANCIAL FLOW FLUIDITY BETWEEN EU FINANCIAL MARKET PLACES

### Why

The full potential of cross-border integration of EU capital markets is far from being realized, although considerable progress has been made since the CMU project started. With Brexit approaching and the ongoing digitalization of financial markets, the need to fully facilitated cross-border capital markets activities is heightened.

Strengthening and deepening the single market for capital promises significant benefits. In addition to considerably enhancing the macroeconomic and financial resilience of the EMU and reducing the need for fiscal risk sharing measures, a true single capital market would constitute a level playing field of considerable size. More competition among financial firms, higher liquidity and reduced compliance costs would lead to a more efficient allocation of capital. In other words, capital market integration ultimately improves the financing of the real economy and strengthens Europe's growth potential.

Irrespective of the precise shape of future relations following the Brexit, non-automatic access from London will result in a significant shift of financial services activities to the EU 27 that will be spread across several financial centers. Due to preexisting fragmentation and lower efficiency of EU's capital markets, this will be associated with rising financing costs for the real economy. Negative effects on financial stability could also be feared. To be efficient and attractive to global business, a regulatory and supervisory race to the bottom between Member States should be avoided and a more uniform approach could be set in motion. As local financial centers expand in volume and scope, increasing requirements on supervisory capacities and potential costs for crisis management could

overstrain the Member States concerned. In addition, existing barriers to financial flows between Member States should be identified and addressed. As a priority, the remaining barriers in the post-trade infrastructure area identified by the European Post Trade Forum should be dismantled with a focus on harmonizing withholding tax collection procedures and removing legal uncertainties in securities laws.

Fintech, on the other hand, will reshape the structures and processes of the global financial system. Digital financial products, e.g. crypto-assets, and business models tend to be cross-border in nature. For a competitive capital market, it is therefore essential to avoid fragmentation along national borders at an early stage to fully reap the benefits of new technologies and innovative financial companies. At the same time, risks to financial stability and consumer protection in the fields of data protection, data security and cyber security should also be addressed at the EU level.

## Transformational recommendations to increase financial flow fluidity between EU financial market centers

For a genuine EU capital market to be understood and operated as a single deep and liquid market, the Next CMU Group has identified at least 3 major ways to enhance fluidity between EU financial centers: (1) Favoring pan-European and Regional consolidation and platforms; (2) Avoiding fragmenting supervisory competition; (3) reinforcing effectiveness of (national) insolvency regimes; and (4) Promoting EU wide Digital Finance and FinTech.

### 1. Favor pan-European and regional consolidation and platforms

Consolidation of market infrastructures and intermediaries contributes to the integration, efficiency and competitiveness of EU financial markets. Cross-border mergers and acquisitions in the financial sector are therefore worth supporting to create more pan-European provision of financial services or facilities platforms. Such consolidation should be driven by market forces and not induced nor refrained by regulation. Financial market regulation should provide an adequate legal framework for market players to interact on a level-playing field and to conduct market consolidation in accordance with market efficiency criteria.

#### a) Critical mass EU market players

The number of mergers or acquisitions that would allow the emergence of highly competitive capital market players with critical mass is far below the opportunities that a genuine Banking Union should create and what the economies of scale permit. In recent decades, mergers of

regulated markets have been rejected or discouraged by EU competition law. The creation of pan-European banks with a significant investment banking business seems to be discouraged by national ring fencing of capital and liquidity measures that outweigh the benefits<sup>1</sup>. In addition, since the financial crisis, banks have significantly reduced cross-border activities. Furthermore, there is an erosion of the market share of EU investment banks on their own market<sup>2</sup>. A true single capital market would allow cross-border large competitive market players to emerge thanks to higher liquidity and reduced costs.

Full for-profit and competition rational as well as the EU trading and post trading legislation have segmented and unbundled the trading chain components resulting into significant market infrastructures fragmentation and higher costs for regulation and compliance. This framework does not necessarily improve market efficiency or reduce costs. On the contrary, the current abundance of equity trading venues heavily challenges price formation veracity. Efficiency and cost reduction is prevented by clearing and/or securities depositaries multiplicity.

#### b) Pan-European platforms (Central Securities Depositories and Consolidated Tape)

Pan-European platforms are facilities that compensate market fragmentation and should preferably be led by market participants or, should that not be the case, by public bodies. They should reduce complexity and costs to efficiently support market integration. In the current EU capital market framework, Central Securities Depositories ("CSDs") and a single Consolidated Tape are two immediate examples where further progress can be achieved.

- **Central Securities Depositories flexible functioning.** CSD Regulation constitutes a very comprehensive set

of rules aiming at integrated, harmonized and safe markets for securities settlement. As CSDs are in the process of implementing such rules to get their CSDR license, clarifying the impact of several provisions will be of assistance. The focus of the European Commission should be to support the implementation process by providing interpretations that allow more flexibility in CSDs service efficiency and innovation. Specifically:

- CSDs need an affordable access to non-domestic currencies which requires adjusting the unduly restrictive rules regarding CSDs settling of transactions in non-Euro currencies using commercial bank money,
  - The CSD Regulation should not reduce the ability of CSDs to offer collateral management, securities lending and borrowing services to market participants. These are key elements of a globally competitive financial market integration and are compatible with the current low risk profile of CSDs,
  - The forthcoming review of the functioning of CSDR should focus on the way it supports issuer opportunities to list across borders facilitating more efficient cross-border post-trade services. Practically, it is still too cumbersome and costly for issuers to list and for investors to manage investment in another Member State. International CSDs are a unique European piece of financial market integration, which the EU should leverage to achieve market integration and global relevance for EU financial markets.
- **EC should establish a single Consolidated Tape facility.** Achieving a Consolidated Tape would make all European market data easily accessible both for professional and retail investors and increase trust for cross-border investments. The European Commission should specify criteria for a single Consolidated Tape covering all execution venues in a delegated act based on MiFID II. Enhancing the quality of market data is needed to make such a tape useful. Such a facility should be non-profit, fall under the responsibility of ESMA and may as a first step cover equity post-trade data.

## 2. Avoid supervisory competition through a strong and coherent EU supervisory framework

So far, the expected benefits from the recent significant EU regulatory harmonization are not fully materializing. Divergent supervisory practices by national supervisors are still a fragmentation factor that creates breaches to the level playing field and unhealthy supervisory competition between National Competent Authorities ("NCAs"). This increases costs, damages genuine EU capital market efficiency and, very often, happens at the detriment of EU wide investor protection.

Accordingly, the Next CMU Group recommends that for a materialization of a true EU capital market, the supervision of the various components of the EU capital markets should be organized in accordance with their respective level of integration. To do so, the Next CMU Group recommends that every time a securities markets Directive or Regulation is reviewed, the European Commission and the co-legislators conduct:

- **a measurement of market integration and supervisory efficiency** objectively made through rigorous pre-agreed criteria (level of cross-border activity, standardization of products and/or services, market concentration, reach of supervisory decisions, global competitiveness, etc.). They should consider the degree of integration of the activity governed by such EU law and the balance between the powers and the responsibilities regarding the distribution of competences. The Next CMU Group recommends allocating the supervisory function at one of the following four levels:
  - 1) De facto NCAs: if it appears that markets are still very local,
  - 2) NCAs and with nonbinding convergence facilitated by ESMA: if there is a meaningful cross-border activity, a need to keep a level playing field and an EU wide investor protection risk,

<sup>1</sup> Mario Draghi: "Similarly, while the free movement of liquidity across borders is made possible by cross-border waivers, the practical application of these waivers is hampered by the remaining national prerogatives in the regulatory framework which allow national authorities to apply large exposure limits on intragroup lending and ring-fence liquidity. For example, the requirement to comply with the liquidity coverage ratio at individual level locks up liquidity in cross-border subsidiaries of G-SIBs of up to €1.30bn. Some of this liquidity could potentially be freely allocated if impediments, such as large exposure limits on intragroup lending, were removed and euro area waivers granted.[16] The effects may be significant, given the importance of intra group lending in the euro area, which in 2017 accounted for 70% of cross-border lending." <https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180918.en.html>

<sup>2</sup> <https://bruegel.org/2016/03/the-united-states-dominates-global-investment-banking-does-it-matter-for-europe/>



- 3) NCAs with compulsory coordination convergence by ESMA: if the market or service at stake is significantly integrated, if supervisory arbitrage causes fragmentation and efficiency losses and, if supervisory fragmentation happens at the detriment of investor protection,
- 4) Direct supervision by ESMA: if the market at stake is highly integrated (standardized product, concentration on few market players, high connections with global market).

- **a reassessment of the Regulatory and Supervisory balance** with the objective of reducing over-reliance on prescriptive and detailed rules that would be compensated by more consistent and rigorous supervision and enforcement. This objective could also be obtained by a more principle based approach in the level 1 legislation, by a reduction of national transposition options and by more extensive use of Regulations (MiFID),
- **an evaluation of the global competitiveness** based on a comparative analysis of the market at stake. A better use of the hierarchy of norms would allow the Union to more promptly react to market changes and to more quickly keep the Single Market attractive and competitive in response to rapid regulatory changes that might occur in third countries.

More specifically, in view of the characteristics of equity markets in the EU 27 and the need to massively develop Equity Markets and maximize fluidity between EU financial centers, the Next CMU Group recommends that for the licensing and supervision of EU-significant equity trading and execution venues (Regulated markets, MTFs, Systematic Internalisers, etc.) and post trading venues (for instance CCPs), ESMA is given a direct competence or at least compulsory coordination powers.

### 3. Reinforce effectiveness of (national) Insolvency regimes

To create a single investment market, corporate insolvency/restructuring regimes are economically important because they affect optimal allocation of resources. The current EU legal landscape with respect to corporate insol-

veny/restructuring regimes is characterized by significant diversity. So far, EU Institution efforts to harmonize national regimes have failed to reduce such diversity and to avoid forum shopping, with the UK emerging as the “market leader” for corporate restructuring in the EU.

The recast “European Insolvency Regulation” (EIR) of 2017 has not substantially reduced the diversity of national regimes as the harmonization was focused mainly on pre-insolvency proceedings and maintained the widely differing national views and policies on core insolvency matters such as the ranking of claims. It is premature to evaluate but even the recent “European Restructuring Directive” (ERD) passed in 2019 is not foreseen to foster actual harmonization as it contains more the 70 regulatory options for the Member States and do not change the persistent diversity of the institutional environment at national level (courts, insolvency professionals, etc.).

Depending on national implementation, considerable and transformational progress should be possible. Member States can significantly improve investment climates by creating modern insolvency regimes and ensuring that these also work in practice.

Although there is widespread agreement about the importance of making progress on insolvency regimes, insolvency law remains an area where Member States in general are quite attached to national specificities. The Next CMU Group therefore recommends several steps:

- Continue the step by step harmonization efforts as defined by the European Commission and make the best use of Commissions help to Member States in modernizing insolvency regimes<sup>3</sup>,
- As an additional step towards a Banking Union, pursue the harmonization of insolvency regimes applicable to credit institutions,
- In parallel, complement the Statute for European Company with a specific chapter on insolvency, which could serve as a benchmark,
- Create a core group of Member States ready to accelerate harmonization.

### 4. Promote cross-border Digital Finance and Fintech

The Next CMU Group believes that reduction of fragmentation and progress towards an integrated EU capital market will be realized through new competitive technologies being implemented on EU market. While technological innovation in finance is not new, both consumers concern and company’s investment in new technologies have substantially increased in recent years. This forms the basis of the financial sector contribution to the wider Digital Single Market.

Foster innovation, financial technology and digitalization should therefore be a key priority for the next institutional cycle. A straight-forward Digital Finance Action Plan aiming at a competitive, secure, innovative and fair EU digital financial market is of utmost importance. The European Commission’s FinTech Action Plan in 2018 was an important first step to enable innovative business models to scale up and support the benefits of new technologies while addressing possible risks especially those related to data protection and cyber security.

The Next CMU Group recommends further rapid and ambitious action in the following areas:

- **Crypto-Assets and Distributed Ledger Technology (“DLT”):**  
ESMA Advice on initial coin offerings and crypto-assets clarified the general existing EU rules applicable to crypto-assets that qualify as financial instruments, however a clear and common EU framework for crypto-assets and tokenization process is needed if the EU wants to stay ahead in this area. Gaps and issues in EU capital market regulation concerning crypto-assets and DLT as identified by the ESAs should be addressed and explained,
- **Pan-European Innovation Facility:**  
a European Forum of Innovation Facilitators (“EFIF”) was established in April 2019 by the European Commission and the ESAs<sup>5</sup>, which is a first step to build a pan-European Innovation Facility that allows to test business models and technology across the EU and provide project specific legislative and regulatory

interpretations. A pan-European Innovation Facility brings a harmonised interpretation of EUs’ regulatory framework and will allow Start-Ups to consider local business while also planning actions on an EU scale. Start-Ups could prepare to offer their products or provide services to clients from different EU Member States. The pan European Innovation Facility should be a combination of a European Sandbox and a European Innovation Hub,

- **A European Sandbox piloted by ESMA**  
to test innovations during a limited time and within a limited scope of potential clients from different EU Member States. It should coordinate NCAs Sandboxes and efficiently liaise with Start-Ups and FinTechs that can test their services in a limited number of Member States simultaneously. If the testing is successful, FinTechs should be able to obtain a license in specified EU Member States. The European Sandbox in coordination with the Innovation Hub Program should analyse if an innovative business model is already covered by EU legislation, or how the legislation needs to be interpreted and accordingly give guidance to NCAs Innovation Hub facilities,
- **Provide for a competitive, fair and secure digital Financial Market Ecosystem:**  
The EU legislation needs to be screened for digital readiness,
- **Big Data and Artificial Intelligence (“AI”):**  
The EU should foster AI to keep pace with the global competition. EU legislation and implementation also needs to be screened with respect to AI-specifics. The support of an EU-wide Financial Data Warehouse and the European Cloud Initiative need to be enhanced,
- **Ensuring consumers’ and investors’ trust in Digital Finance** is a key success factor. While strengthening the European capital market’s competitiveness by encouraging cross-border digitalization, a high level of protection for consumers and investors in financial products and services should be ensured. Digital financial service providers can easily access the EU wide capital market and operate cross-border risking supervisory competition negatively impacts

3 The Commission has helped both Greece and Cyprus modernize their insolvency laws and has created the Structural Reform Support Service within its General Secretariat, to help Member States, on demand, with structural reforms.

4 [https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391\\_crypto\\_advice.pdf](https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf)  
5 <https://europa.eu/rapid/midday-express-02-04-2019.htm>

investors' interest. A Single Market in retail financial services needs adequate levels of investor protection through consistent and rigorous harmonized enforcement across Member States. Special emphasis must be placed on data protection, data privacy and cyber security. The EU financial architecture needs to be harnessed to deal with the resulting risks,

- If by nature FinTech solutions easily result in cross border provision of services applicable rules should be the same in all Member States, the supervisory function should be allocated to ESMA, or to NCA's under compulsory coordination by ESMA.



Kindergarten, KfW-Bildarchiv/-, Germany, August 2005

## Transformational recommendations:

### 10. Allow the emergence of competitive pan-European and regional market players with critical mass, by supporting cross-border mergers and acquisitions in the financial sector.

Supporting cross-border mergers by rebalancing liquidity, capital restrictions and legal constraints without endangering the overall EU financial stability.

### 11. Review the Central Securities Depositories ("CSD") Regulation.

Such revision should aim at facilitating more efficient cross border post trading services for issuers and investors. CSD Regulation should not reduce the ability of CSDs to offer collateral management, securities lending and borrowing services to market participants. Furthermore, the efficiency of CSDs should be improved by widening the scope of instruments they are allowed to use.

### 12. Establish a single market data Consolidated Tape.

The European Commission should specify criteria for a single Consolidated Tape covering all execution venues in a delegated act based on MiFID II. The consolidated tape should be non-profit, fall under the responsibility of ESMA and may as a first step cover equity post-trade data.

**13. Avoid supervisory competition through a strong and coherent EU supervisory framework,** which progressively allocates the supervision function at different layers with respect to the level of market integration, every time a Directive or Regulation is reviewed. Start by providing ESMA with direct or compulsory indirect supervision function on EU-significant equity trading and post trading venues.

### 14. Reassess the regulatory and supervisory balance.

Reduce overreliance on prescriptive and detailed rules and compensate that by more consistent and rigorous supervision and enforcement. This could also be obtained by a more principle based approach in the level 1 legislation and by a reduction of national transposition options and more extensive use of Regulations (MiFID).

### 15. Reinforce effectiveness of insolvency regimes across the EU.

Continue the harmonization efforts as defined by the European Commission. Pursue the harmonization of insolvency regimes applicable to credit institutions and in parallel, complement the Statute for European Company with a specific chapter on Insolvency.

### 16. Elaborate an ambitious EU wide Digital Finance Action Plan.

Such an Action Plan should capture the inherent cross-border dimension of digital finance which calls for establishing a European Sandbox and strengthening an Innovation Hub Program, for screening of EU legislation for digital readiness and for ensuring consumer and investor trust with respect to data protection and cyber security. The aim should be a competitive, secure, fair and innovative European digital single financial market, with ESMA granted with a compulsory convergence role in this area.



## Chapter 4

# DEVELOP DEBT, CREDIT AND FOREX FINANCING TOOLS IN A MANNER THAT INCREASES THE INTERNATIONAL FUNDING CURRENCY ROLE OF THE EURO

## Why

A stronger use of the euro as an international funding currency brings many advantages for citizens, companies and Member States. These include not only lower costs for financing and in international trade, but above all more autonomy for monetary policy and international payments. The latter has gained in importance against the background of the shifting global order and the growing application of unilateral sanctions, which encompass the loss of access to the international financial system. A higher share of the euro in the international bond, credit and foreign exchange markets would also contribute towards greater depth and liquidity of the EU capital markets and thus decisively support the development of the EU capital markets.

The economic benefits of greater international use of the euro are largely undisputed<sup>1</sup>:

- (i) Internationally active companies gain from lower transaction costs and exchange rate risks if they can trade in their domestic currency,
- (ii) Economies whose currencies are used significantly for reserve purposes enjoy the “exorbitant privilege”. Increasing demand from foreign official investors reduces financing costs for EU households, companies and governments,
- (iii) As an issuer of an international currency, the ECB is less exposed to the repercussions of interest rate decisions by other central banks and can act autonomously in terms of monetary policy,

(iv) The shock absorption of the monetary union would improve. On the one hand, through the low impact of exchange rate fluctuations on domestic inflation, on the other hand through the greater stability of a deeper and internationally diversified market.

Recent events and the challenges to multilateralism have rightly added a geopolitical dimension to the debate on the international role of the euro<sup>2</sup>. The use of unilateral, extra-territorial sanctions shows that a higher weight of the Euro in the international financial system is a necessity to ensure unhindered access to international payments and financing for EU companies, banks and consumers. Furthermore, a stronger role for the euro would contribute to a more balanced international financial system and give weight to EU interests across the world.

The euro already plays a pivotal role as an international currency. By all commonly used measures – foreign exchange reserves, international debt, international loans, foreign exchange turnover, global payment currency, and global trade invoicing – the euro is the second-most important currency in the world. However, the gap between the use of the US dollar and the euro is still very large, especially regarding their use as foreign exchange reserve and as funding currency, be it loans or other debt instruments.

According to an index calculated by the European Central Bank (“ECB”), the international role of the euro decreases, as a trend, since around 2006<sup>3</sup>. The most important factor driving this development seems to have been the

<sup>1</sup> See ECB, The international role of the euro, June 2019, pp. 38-44.

<sup>2</sup> See Coeuré, The euro’s global role in a changing world: a monetary policy perspective, February 2019.

<sup>3</sup> ECB, The international role of the Euro, June 2019, p.5.

financial and the euro crisis. Also, the growing importance of China and its renminbi is said to play a role. Since 2017 a slight rise in the importance of the euro as international currency can be observed.

Two main drivers can be identified to explain the euro's loss of importance. First, the receding stability in the euro zone and second, the ebbing depth and liquidity of the euro area financial markets. Regarding the stability of euro-zone assets, international investors, including central banks, who search for safe assets as stores of value had to face a dramatic decline in high-quality euro-zone sovereign bonds when the financial and, later, the euro crisis hit the currency block. In addition, the crises also strongly aggravated the fragmentation of the euro area's financial market, reducing its depth and liquidity.

Acknowledging the high potential of a global use of the euro, the European Commission formulated a comprehensive package at the end of 2018 to strengthen again the global significance of the euro<sup>4</sup>. This includes measures to complete the Economic and monetary Union ("EMU"), to foster a deep EU financial sector and initiatives relating to international financial and key strategic sectors.

The Next CMU Group support these efforts as ultimately,

efficient EU capital markets and the global significance of the euro are two sides of a coin. Deeper and highly integrated EU capital markets strengthen the international attractiveness of the euro. At the same time, the growing use of the euro by international investors and issuers in turn has a positive effect on the liquidity and depth of EU capital market. A virtuous circle might ensue and, for the specifics of our report, successful implementation of the previous priorities as described in this report will contribute substantially.

The following recommendations complement the European Commission's previous initiatives with a focus on measures to raise the profile of the euro and EU capital markets as a reference, sustainable, inclusive, open and efficient brand<sup>5</sup>.

## Transformational recommendations to develop Debt, Credit and Forex financing tools in a manner that increases the international funding currency role of the euro

For a genuine EU capital market to be understood and operated as a single deep and liquid market, the Next CMU Group has identified at least 3 major ways to enhance fluidity between EU financial centers: (1) Favoring pan-European consolidation and platforms; (2) Avoiding fragmenting supervisory competition; (3) Reinforce effectiveness of (national) insolvency regimes; and (4) Promoting EU wide Digital Finance and FinTech.

### 1 Create the conditions to further establish the euro as a reference asset currency

Increasing the supply of reference assets would help the euro to boost its international use. Despite this unchallenged diagnosis, there is currently no simple solution for the establishment of a common reference asset for the euro zone. As a result, the euro zone lacks a benchmark yield curve. At least in the long-term, efforts to achieve a common reference asset should not be abandoned. In the meantime, sound economic policies and risk reduction should strengthen international confidence in the euro.

A truly risk-free asset will not be found as each asset represents a risk – even sometimes very small. However, there are certain criteria that indicate that an asset is considered as a reference. These are:

- a) Market participants (such as insurance companies, pension funds or central banks) use these assets as their preferred asset class and value-preserving liquidity storage,
- b) Closely related, a reference asset is used to meet supervisory requirements about capital buffers, liquidity ratios and Net Stable Funding Ration (NSFR),
- c) The yield of a reference asset is a source of information for market participants on various

financial market indicators such as interest rate expectations, term premiums or inflation expectations. It also serves as benchmark yield to calculate risk premiums for other assets and therefore for its very own pricing.

To be such an asset, the market for the asset should be broad (different characteristics such as different maturities) and deep (high volumes). There are no bottlenecks and market players can buy and sell at any time. Price formation proceeds frictionless and there is no market distortion, so that the market, the asset and its price accurately reflect all information. Moreover, a reference asset market is characterized by the absence of market barriers and limits. Crucially, the issuer of the asset should enjoy the greatest possible trust, which is expressed in a high credit rating and a near zero default risk, respectively.

It is clear at first glance that none of the euro area capital markets meet most of these criteria. Eurozone markets are divided into national markets. The deepest is the one for German government bonds that is – roughly ten times smaller than the US government bond market – too small for a global reference asset market. German government bonds are currently yielding completely below the zero-line suggesting a general shortage of this asset. Consequently, euro area capital markets are not able to offer a Eurozone-wide low-risk asset across the euro area that can be used as a common yield curve that works as a benchmark. Both aspects would be essential for financial integration and the EU capital markets.

Considerations about a common reference asset should continue to strengthen the international role of the euro.

### 2 Sovereign Green Bonds as a flagship product for EU capital markets

Europe already holds the top position as the largest market for Green Bonds<sup>6</sup>. This helps further strengthening the euro as a financing currency for sustainable projects. Sovereign Green Bond issuers are in a prominent position to increase supply by offering highly liquid benchmark size investment opportunities and contribute to a further development and diversification of the Green Bond market on a EU but also on an international scale.

<sup>4</sup> European Commission (Communication), Towards a stronger international role of the euro, December 2018

<sup>5</sup> Without prejudice to other EU national currencies and their role for non-euro EU capital markets.

<sup>6</sup> Climate Bonds Initiative, Green Bonds, The state of the market, 2018.

However, individual, sporadic market appearances are not sufficient to meet this requirement. Rather, the major sovereign issuers should commit themselves to implementing a comprehensive issuance program for Green Bonds that consistently covers the maturity range between 2 and 30 years.

By issuing sovereign Green Bonds, Member States can demonstrate their commitment to reach the Paris Agreement's 2°C goal<sup>7</sup> and the objectives of the EU Roadmap 2050<sup>8</sup>. In addition, they positively contribute to the 2030 Agenda for Sustainable Development<sup>9</sup>. Climate mitigation and adaptation underpin meeting the UN Sustainable Development Goals ("SDGs"). Fighting climate change is reliant on approaching SDGs with a climate lens, especially Clean Water & Sanitation (SDG6), Affordable and Clean Energy (SDG7) Industry Innovation & Infrastructure (SDG9), Sustainable Cities (SDG11) Climate Action (SDG13) and Life on Land (SDG15). Hence, Green Bonds can serve as a bridge to achieving SDGs.

By defining common EU Sovereign Green Bond Standard referring the EU taxonomy –currently in slow development under the "EU Action Plan Financing Sustainable Growth"<sup>10</sup> – the sovereign issuers would advance the harmonization of Green products on the capital markets.

Sovereign Green Bond issuers should in a more harmonized manner commit to be transparent within Member States budgets and report on environmental beneficial or sustainable activities. The development of common practices has a crucial impact on effectively fulfilling these commitments. Sovereign issuers are best-suited to serve as role models for other market participants. By demonstrating best practice, e.g. about impact reporting, sovereign Green Bond issuers can create important momentum to increase data quality and availability, harmonize the respective processes and methodologies and could serve as a driver for corporate Green Bond issuers. On a wider scale, this transparency on sustainable activities can be the origin for a committed international cooperation within and beyond the EU as well as for

determined impulses about the domestic economy and society.

### 3 Revitalise securitization markets to foster inclusive growth

Since the financial crisis, securitizations have dramatically reduced in importance. However, in recent years it has recovered somewhat from its lows in 2013/14<sup>11</sup>. In 2015, the European Commission proposed a framework for Simple, Transparent and Standardised securitizations ("STS"), which possibly contributed to the above-mentioned slight rebound of the securitization market. This said, the STS standard didn't meet the expectations for the following reasons:

- a) A noticeable deleveraging environment in both the corporate and banking sectors. After the so-called Euro crisis, which was perceived by many observers as a debt crisis, both companies and businesses as well as banks reduced their debt. This has reduced the securitization scope for banks,
- b) Unfavourable regulatory treatment: As the financial crisis was mainly caused by the securitisation and banking markets, supervisors have made great efforts to minimise the risks posed by the banking sector. This has led to a high capital buffer requirement, not least for securitization investors,
- c) Lower refinancing costs for competing asset-backed financial instruments, notably covered bonds<sup>12</sup>,
- d) A low interest rates and competitive spread environment.

To revive the EU securitisation market in Europe, strengthen the international role of the euro and contribute further to SME financing, the EU Commission, supervisors and Member States should:

- a) Provide implementation certainty for the securitization industry including on capital relief. The ESAs and the European Commission should finalize all RTS and other regulatory documents and intensify Q&As,
- b) Simplify and streamline regulatory requirements for disclosure, STS criteria, STS verification and by providing simple and risk sensitive parameters for assessment of Significant Risk Transfer. Realigning the treatment of cash and synthetic securitizations could also be considered at the next review of the STS framework,
- c) When reviewed, the STS Regulation should be calibrated in such a way that it realigns the regulatory capital and liquidity treatment with those of covered bonds and loans, as well as the disclosure and due diligence requirements for covered bonds and STS securitization.

### 4 Promote cross-border Digital Finance and Fintech

Instant payments are quickly emerging as the new normal<sup>13</sup>. The EU has already taken significant steps to address this development. In November 2018, the ECB launched TARGET Instant Payment Settlement ("TIPS") which allows to settle payments individually with central bank money in less than 10 seconds<sup>14</sup>. The SEPA Instant Credit Transfer ("SCT Inst") creates the conditions for a widespread used pan-European solution for retail instant payments. There are, however, risks that the payment market will become fragmented<sup>15</sup>, which would also damage the international role of the euro in the long run.

Currently, solutions for instant payments at the point of interaction are regional or national and lack interoperability. The Next CMU Group therefore recommends the EU and the Member States to promote and support efforts to find a true pan-European solution.



Seniorenpaar mit Stöcken beim Spaziergang, KfW-Bildarchiv / photothek.net, Germany, April 2012

7 European Commission, International action on climate change, Paris Agreement.

8 European Commission (press release), The Commission calls for a climate neutral Europe by 2050, November 2018.

9 UN, Transforming our world: the 2030 Agenda for Sustainable Development.

10 European Commission (Communication), Action Plan: Financing Sustainable Growth, March 2018.

11 The European securitization market recorded an issue volume of EUR 258 billion in 2018, around EUR 60 billion more than in 2013 and 2014.

12 For example, since mid-2014, the outstanding amount of mortgage covered bonds in Germany has shown a much more dynamic upward trend than the securitization market in the same period.

13 See Swift, The transformation of the European payment landscape, pp. 18.; Hartmann, M. et al., Are instant payments becoming the new normal? A comparative study, August 2019.

14 ECB (press release), ECB goes live with pan-European instant payments, November 2018.

15 Lautenschläger, S. (speech), Transformation of the retail and wholesale payments landscape in Europe, June 2019.

## Transformational recommendations:

### 17. Create the conditions to establish the euro as a reference asset currency.

Member States, Institutions and market participants should create the conditions to develop a common market for reference assets for the euro area that truly meet the criteria for reference assets. The euro area lacks a euro area-wide benchmark yield curve.

### 18. Establishing Sovereign Green Bonds as a flagship product for EU's capital markets.

The issuance of Green Bonds by Member States has a significant signalling effect to the capital market and should become an integral part of their funding strategy. Member States with significant activity on the debt market should have issued a Green Bond and agreed common standards for budgeting and reporting requirements by 2021.

### 19. Revitalising securitization markets.

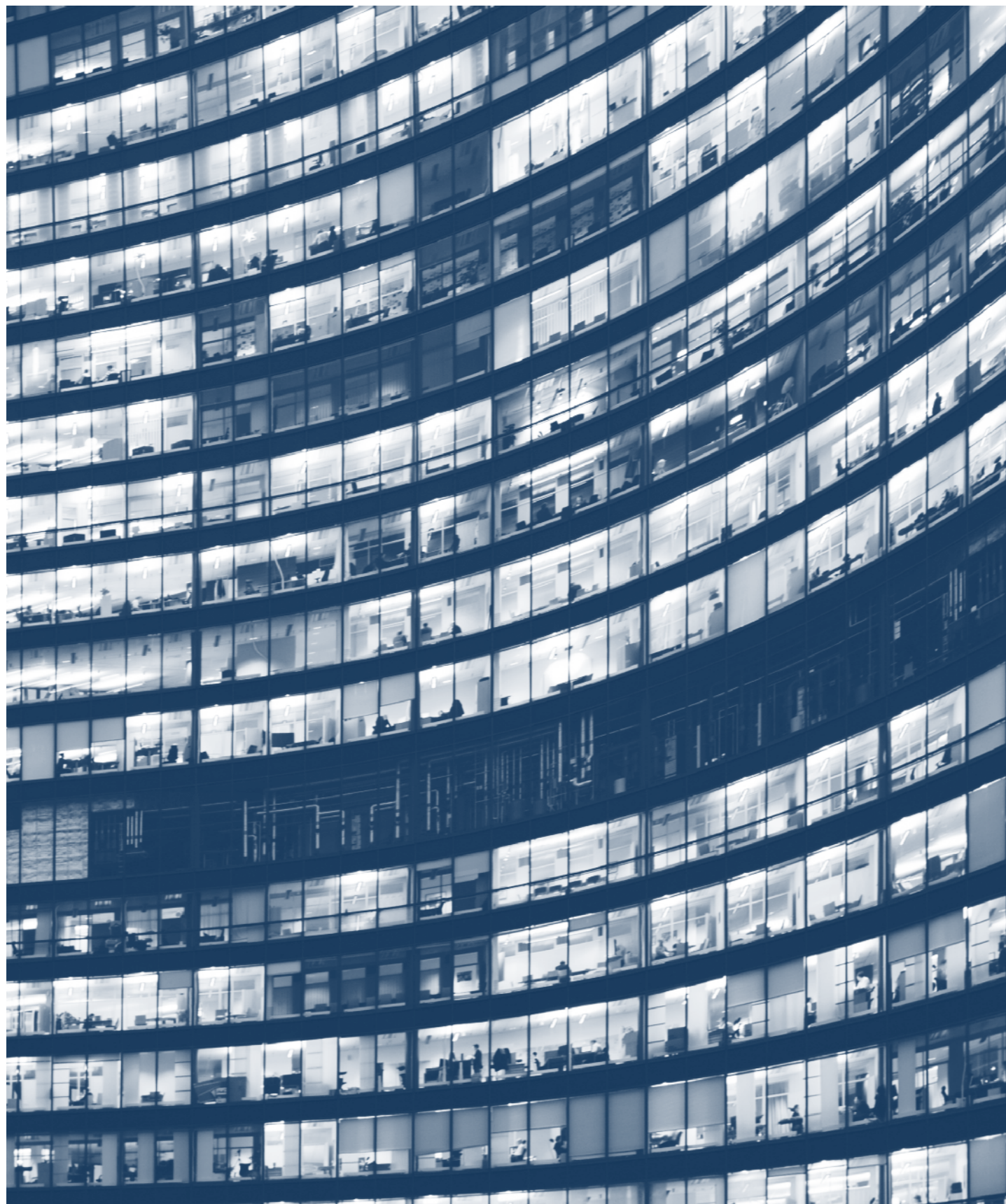
A deep and well-functioning securitisation market that can recover strongly from the lows of 2013/14 is an essential element of a dynamic capital market and for euro area lending, including for SMEs. Where possible the regulatory and supervisory framework for STS Regulation should be accelerated and when reviewed, a key task will be to ensure that regulation is neutral between securitization and similar instruments like covered bonds. In view of such a revision the revitalisation of the securitizations market should be closely monitored.

### 20. Ensure an efficient and competitive pan-European payment market.

Europe already has a highly efficient and secure payment infrastructure. Digital innovations and global trends have moved the demand for retail instant payment services into focus. To avoid fragmentation of the payment market, pan-European solutions should be decisively supported. Instant payments as a new payment infrastructure within the Single Euro Payments Area (SEPA) can play a major role.



Offshore-Wind-Park, KfW-Bildarchiv /  
Charlie Fawell, Great Britain,  
February 2008



## CONCLUSION

**Within this report the Next CMU Group proposes a shift of priorities.**

From a first phase of the CMU that focused on revitalizing EUs capital market ecosystem, it recommends that the new phase gives priority to responses to citizens' needs and to the investment in the real, digital and sustainable EU economy. People, Sustainability and Digitalization are the three priorities of the new European Commission.

Should political leaders of the three Institutions wish to widely signal such new orientation they could even consider changing the name of the CMU. This would make the purpose of such Union clearer for citizens and for the real, Digital and Sustainable economy. The Next CMU Group proposes the following new name: **Savings and Sustainable Investment Union.**

The four Absolute Priorities and twenty Transformational Recommendations detailed in this report, by the Next CMU Group all point in that direction and set the ambition of building an integrated, competitive, deep and liquid EU capital market, to maintain the EU as one of the top two financial centers of the world.

The progressive achievement of additional EU legislative efforts will not, on its own, bring a sufficiently efficient and rapid response to the current pressing urgency and will not create an impactful difference. Reaching such ambition may require further EU legislation but perhaps even more, a revised regulatory and supervisory balance, action by the ECB and central banks, legal and tax changes at national level, and consistent private sector initiatives.

Effective implementation and tangible results are the key success factors. To regularly evaluate if the EU achieves its agreed key objectives in the priority areas, the Next CMU Group suggests that the European Commission formulates:

- Concrete Key Performance Indicators ("KPIs") measuring the EUs' capital market efficiency over several years, such as: overall pensions targets, retail participation in the equity market, Venture Capital funding level, number of late-stage Private Equity funds, number of IPOs by SME and Mid-Cap, equity holding by Institutional investors, number of FinTech emerging, use of the Euro in global markets, issuances of Sovereign Green Bonds.
- Heatmaps to follow the implementation and real functioning of specific capital market features at EU level and in the Member State, such as: funding and tax incentives, standards implementation, structural evolution of the market (M&A), functioning of specific EU platforms.

The European Commission could even consider proposing to establish a Monitoring Steering Committee of inter institutional nature in charge of setting the concrete key performance indicators and expected outcomes and to periodically monitor progress and report.

## NEXT CMU HIGH-LEVEL GROUP COMPOSITION

- **Fabrice DEMARIGNY (Chair)**, Partner at Mazars, Chair of the Board of the European Capital Markets Institute (ECMI)
- **Corien WORTMANN-KOOL (Co-Chair)**, Chair of the Board of ABP Pension fund
- **Joachim NAGEL (Co-Chair)**, Executive Board Member of KfW
- **David VEGARA**, Chief Risk Officer and Executive Board Member of Banco Sabadell
- **Lauri ROSENDAHL**, President of Nasdaq Nordics and Nasdaq Stockholm and Senior Vice President of European Cash Equity and Equity Derivatives within Global Transaction and Market Services
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### The work of the Next CMU High-Level Group is supported by:

- Johan BARNARD (Coordinator)
- Laurent CLAMAGIRAND (Senior Advisor)
- Elina YRGARD
- Romana RIES
- Amine ATTIOUI

## ANNEX

### Institutions, authorities and organisations met or from whom a contribution was received

#### International organisations

- International Monetary Fund
- Organisation for Economic Cooperation and Development

#### EU bodies

- Economic and Financial Committee
- European Banking Authority
- European Central Bank
- European Commission
- European Insurance and Occupational Pensions Authority
- European Investment Bank
- European Securities and Markets Authority
- Finnish Presidency and the ECOFIN
- Some members of the European Parliament

#### National authorities

- **Ministries**
  - o Dutch Ministry of Finance
  - o Finnish Ministry of Finance
  - o French Ministry for the Economy and Finance
  - o French Ministry of European Affairs
  - o German Federal Ministry of Finance
  - o Italian Ministry of Finance
  - o Polish Ministry of Finance
  - o Spanish Ministry of Finance
  - o Spanish Ministry of Justice
  - o Swedish Ministry of Finance
- **Central banks**
  - o Banco de España
  - o Bank of France
  - o De Nederlandsche Bank
  - o Deutsche Bundesbank
  - o National Bank of Poland
  - o Riksbanken (Swedish Central Bank)

#### Supervisors

- o ACPR (French Prudential Supervision and Resolution Authority)
- o AFM (Netherlands Authority for the Financial Markets) + Capital Markets committee
- o AMF (French Financial Markets regulator)
- o CNMV (Spanish securities supervisor)
- o CONSOB (Italian Securities Regulator)
- o Finansinspektionen (Swedish Financial Supervisory Authority)
- o KNF (Polish Financial Supervision Committee)
- o UK Financial Conduct Authority

#### Other public institutions

- o City of London Corporation
- o ICO (Instituto de Crédito Oficial)

#### Interested parties

- ABI (Italian Banking Association)
- ABN AMRO Clearing Bank
- AEB (Spanish Banking Association)
- AEGON
- AFEP (French Association of Private Companies)
- AFG (French Asset Management Association)
- AFME (Association for Financial Markets in Europe)
- AIFI (Italian Private Equity, Venture Capital and Private Debt Association)
- Alecta
- Allianz Deutschland AG
- Alternative Credit Council
- AIMA
- AMAFI (French Financial Markets Association)
- Amundi
- ANIA (Italian Insurance Companies Association)
- Asociación Española de Banca, AEB (Spanish Banking Association)
- Ardian
- Assirevi (Italian Association of Audit firms)
- Assogestioni (Italian Association of Asset Management)
- Assosim (Italian Brokers Dealers Association)



- Aviva
- AXA
- Bank of America Merrill Lynch
- Bank of China
- Bank of New York Mellon
- Banque Publique d'Investissement
- Better Finance
- Blackrock
- BNP Paribas
- Bolsas y Mercados Españoles
- Bond Spot MTF
- Borsa Italiana
- Börse Stuttgart
- BOS Dom Maklerski
- BPCE
- BPF (Banking & Payments Federation Ireland)
- Bundesverband deutscher Banken e.V.
- BVI (German Investment Funds Association)
- C\*boe
- Caisse des dépôts et consignations
- Cevian Capital
- CFA Society Poland
- Chicago Board Options Exchange Europe
- Citi Bank Handlowy Dom Maklerski
- Citigroup Global Markets
- Confederación Española de Cajas de Ahorro (CECA)
- Confindustria (Italian General Confederation of Italian Industry)
- Copernicus Securities
- Covéa
- Crédit Agricole
- Crédit Suisse
- Deutsches Aktieninstitut
- Deutsche Bank
- Deutsche Börse
- De Brauw
- DSGV (Deutscher Sparkassen- und Giroverband)
- DUFAS (Dutch Fund and Asset Management Association)
- DZ Bank AG
- EFAMA
- EFS Roundtable
- Emisores Españoles
- EPTA (European Principal Traders Association) (Piebe Teeboom)
- Erste Group
- ESBG (European Savings and Retail Banking Group)
- Eumedion
- Euronext
- European Banking Federation (+ Markets4Europe)
- European Institute of Financial Regulation
- EuropeanIssuers
- FBF (French Banking Federation)
- FeBAF (Italian Banking, Insurance and Finance Federation)
- FESE
- FFA (French Insurance Federation)
- Finance Finland
- Financière de l'échiquier
- France Invest (French PE and VC Association)
- GDV (German Insurance Association)
- Goldman Sachs
- Holland FinTech
- HSBC
- HVG Law
- IDM (Polish Association of Brokerage Houses)
- IGTE (Chamber of commerce of Pension Funds in Poland)
- InsuranceEurope
- IntercontinentalExchange
- International Capital Market Association
- International Regulatory Strategy Group
- International Securities Lending Association
- International Swaps and Derivatives Association
- INVERCO
- Invesco
- Invest Europe
- IZFA (Polish Investment Companies Association)
- Johann Wolfgang Goethe-University Frankfurt
- JPMorgan
- JSternCo
- KDPW (Central Securities Depository of Poland)
- LCH group
- Long term Investment Task Force
- Meridiam
- Michael Ström Dom Maklerski
- Mouvement des entreprises de France
- Nasdaq
- Natixis
- NatWest
- Noble Securites Dom Maklerski
- NVB (Dutch Banking Association)

- NVP (Dutch Private Equity and Venture Capital Association)
- Optiver
- Ostrum
- Paris Europlace
- Pensions Europe
- PFR Ventures
- PGGM
- PKO BP Bank
- PKO BP Dom Maklerski
- Prague Stock Exchange
- PSIK (Polish VC and PE funds Association)
- Rada Banków Depozytariuszy (Council of Depositary Banks in Poland)
- Rzecznik Finansowy RP
- Santander Bank Polska
- Schroders
- SEG (Polish Association of Listed Companies)
- Slaughter & May
- SME Sweden
- Société Générale
- StartupDelta
- Stern and Co
- Stowarzyszenie Inwestorów Indywidualnych (Association of individual investors in Poland)
- Stratticus
- SVCA (Swedish Private Equity & Venture Capital Association)
- Svenska Fondhandlareföreningen (Swedish Securities Dealers Association)
- Svenskt Näringsliv (Swedish Confederation of Enterprises)
- TMS Brokers
- Unicredit
- Unión Nacional de Cooperativas de Crédito (Cooperatives Association)
- VEB (Dutch Investors Association)
- Verbond van Verzekeraars (Dutch Association of Insurers)
- VNO-NCW – The confederation of Netherlands Industry and Employers
- Warsaw Stock Exchange
- Związek Banków Polskich (Polish Banking Association)

#### Think tanks, NGOs and Universities

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- CEPS
- New Financial
- Frankfurt School of Finance and Management
- Johann Wolfgang Goethe-University

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