Green Paper – Building a capital Market Union

Section 1: Building a Capital Markets Union

The free movement of capital was enshrined in the Treaty of Rome more than fifty years ago. It is one of the fundamental freedoms of the European Union and should be at the heart of the single market. Yet despite the progress that has been made, capital markets today remain fragmented and typically organised on national lines. Following a period of deepening, the degree of financial market integration across the EU has receded since the crisis, with banks and investors having retreated to home markets.

European businesses remain heavily reliant on banks, which makes the economy vulnerable to a tightening of bank lending. There is insufficient investor confidence, reflected in the differences in savings and investment patterns. European investment levels are well below their historical norm and due to lack of scale European capital markets are less competitive at the global level.

To help support a sustainable return to growth and job creation, capital markets need to play a larger role in channelling financing to the economy. In practice this means ensuring that obstacles to the movement of capital between investors, and those who need funding, whether it be within a Member State or cross border, are identified and broken down, and progress towards a true single market for capital is made.

As President Juncker set out in his political guidelines for the new Commission, a Capital Markets Union would ensure greater diversification in the funding of the economy and reduce the cost of raising capital. In particular it would:

- **enhance the flow of capital** from investors to European investment prospects in need of financing, notably start-ups, SMEs and long-term projects;

- ensure that market infrastructures and intermediaries can **channel funds across borders** to companies that want to finance their growth efficiently, at reasonable cost and on the same terms as nationally;

- **improve risk transfer** and allocation of capital across the EU to those better able to bear it; and

- **diversify sources of funding**, by expanding risk finance and making Europe less reliant on bank lending and more resilient to shocks.

The Commission has therefore committed to put in place the building blocks of a well-regulated and integrated Capital Markets Union, encompassing all Member States, by 2019, with a view to maximising the benefits of capital markets and non-bank financial institutions for the wider economy.

In practice, the building blocks of Capital Markets Union should move the EU closer towards a situation where, for example, SMEs can raise financing as easily as large companies; costs of investing and access to investment products converge across the EU; obtaining credit through capital markets is increasingly straightforward; and seeking funding in another Member State is not impeded by unnecessary legal or supervisory barriers. While these changes will help to reduce reliance on bank financing, as lenders to a significant proportion of the economy and intermediaries in capital markets, banks will play a central role in Capital Markets Union and will continue to play a vital part in the European economy.

Not all of these challenges are new, but the EU's need for growth makes them pressing to solve. It also provides the momentum needed to make progress. The purpose of this green paper is to begin the debate at EU and national levels, involving the co-legislators, other EU institutions, national parliaments, and all those interested, on the possible short and longer-term measures to achieve these objectives.

Capital Markets Union will be different from Banking Union: deepening capital markets requires steps that will be different from the key elements of Banking Union. However, the Banking Union's focus on breaking the link between bank failures and sovereigns in the euro area will provide a platform of stability and confidence to underpin the development of a Capital Markets Union across all EU28 Member States.

A Capital Markets Union should be based on the following key principles:

- it should maximise the benefits of capital markets for the economy, growth and jobs;
- it should be built on firm foundations of financial stability, with a single rulebook for financial services which is effectively and consistently enforced;
- it should create a single market for capital for all 28 Member States by removing barriers to cross-border investment within the EU;
- it should ensure an effective level of consumer and investor protection; and
- it should help attract investment from all over the world and enhance EU competitiveness.

1.1 Delivering a Capital Markets Union

Building a Capital Markets Union is a long-term project. Work is already underway to establish a single rulebook, with a large number of key reforms[1] in the process of being implemented. Our approach will be based on an assessment of the outstanding priorities, both in terms of likely impact and feasibility, underpinned by thorough economic analysis, impact assessment, and consultation.

On the basis of the outcome of this consultation, the Commission will seek to identify the actions that are necessary to achieve the following objectives:

- improving **access to financing** for all businesses across Europe and investment projects such as infrastructure;
- **increasing and diversifying the sources of funding** from investors in the EU and all over the world; and

[1] Such as the legislation on markets in financial instruments (MIFID II), market abuse (MAR/MAD), Alternative Investment Fund Managers (AIFMD), European market infrastructure (EMIR) and central securities depositories (CSDR)

- making the **markets work more effectively** so that the connections between investors and those who need funding are more efficient and effective, both within Member States and cross-border.

The Commission will consult widely on the nature of the problems, possible measures and their prioritisation. It is clear that legislation at EU level will not always be the appropriate policy response to these challenges, and the onus in many cases will be on the market to deliver solutions. Non-legislative steps and the effective enforcement of competition and single market laws might offer the best way forward in other areas. We will support market-driven solutions where we can and regulatory changes only where they are necessary.

The Green Paper is structured as follows. **Section 2** describes how European capital markets are currently structured and provides a preliminary analysis of some of the barriers to deeper capital markets. Further analysis is provided in the Staff Working Document accompanying this paper. **Section 3** seeks views on the early policy priorities we intend to take forward, building on the Commission Communication "*An Investment Plan for Europe*"[2] which identified initial areas for action such as the implementation of the European Long-term Investment Funds (ELTIF) Regulation, high quality securitisation, standardised credit information on SMEs, private placement and the review of the Prospectus Directive. These are areas where there is potential to make early progress.

Section 4 of the paper seeks views on obstacles to cross border capital flows, such as insolvency, corporate, taxation and securities laws, where further analysis and feedback is needed to identify the scale of the challenge in each area, and the appropriate solutions and degree of prioritisation. This section also seeks views on other barriers to increasing access to finance, widening sources of funding and making markets work better and where we may take forward further work on the basis of the feedback received.

By further opening national markets for investors, issuers and intermediaries, promoting the free flow of capital and sharing best practices, the Capital Markets Union should also be seen as a tool to help markets develop at national level. Given the diverse levels of development of capital markets across the EU and the existence of specific challenges in different Member States, policy responses may require appropriately tailored action at national level, based, *inter alia* on the country specific recommendations of the Commission in the context of the European Semester. The Commission invites Member States to consult on specific challenges to the development of capital markets at national level and to feed their conclusions into the debate.

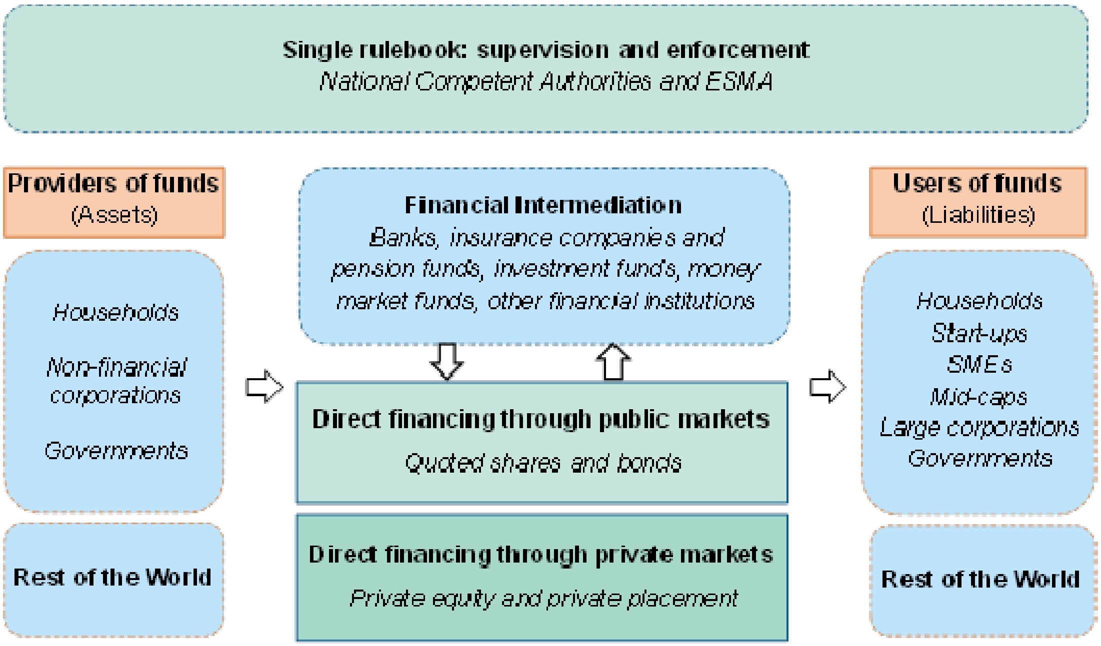
[2] COM(2014) 903 final, 26.11.2014

Section 2: Challenges in European Capital Markets today

2.1 Current state of capital markets in Europe

Capital markets provide diversified funding sources for the economy. Chart 1 illustrates a simple view of the flow of funds in an economy. Whilst capital markets are predominantly concerned with direct financing, they are also closely interlinked with financial intermediaries who often channel funds from savers to investors.

Chart 1. Stylised view of capital markets in the broader financial system

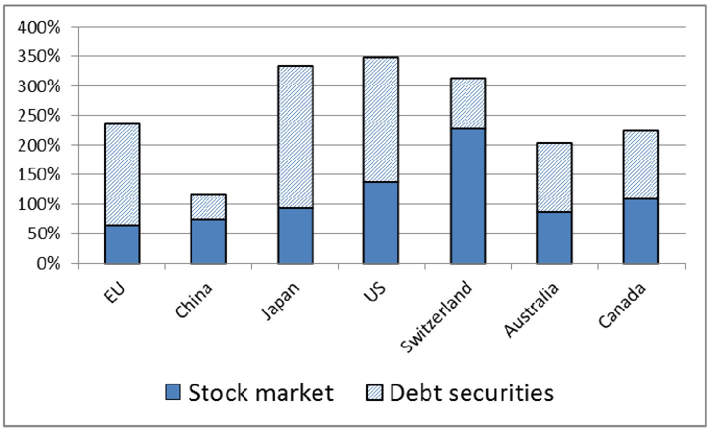


Capital markets have **expanded significantly in the EU** over recent decades. Total EU stock market capitalisation, for example, amounted to €8.4 trillion (around 65% of GDP) by end 2013, compared to €1.3 trillion in 1992 (22% of GDP). The total value of outstanding debt securities exceeded €22.3 trillion (171% of GDP) in 2013, compared to €4.7 trillion (74% of GDP) in 1992[3].

Nonetheless, many EU capital markets remain underdeveloped in comparison with other jurisdictions. Public equity markets in the US are almost twice the size of those in the EU (expressed as a percentage of GDP) and are three and a half times bigger in Switzerland (chart 2).

[3] ECMI Statistical package 2014.

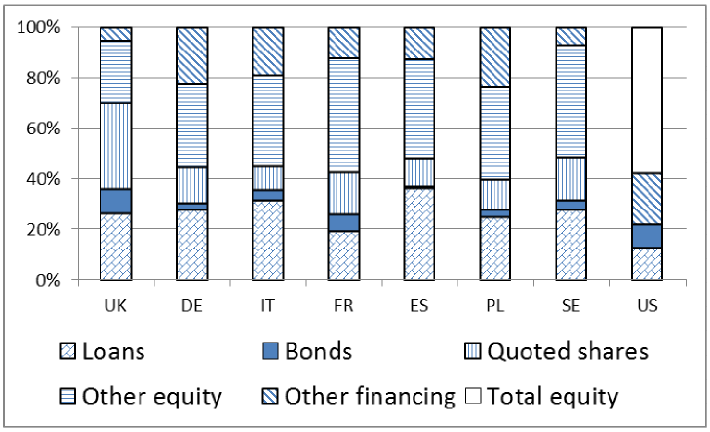
Chart 2: Stock market capitalisation and debt securities (% of GDP)



Source: ECMI statistical package

Private equity markets in the US are also about twice the size of those in the EU, whilst private placement markets for bonds are up to three times bigger in the US. At the same time there is wide variation in capital market development across EU Member States. For example, domestic stock market capitalisation exceeded 121% of GDP in the UK, compared to less than 10% in Latvia, Cyprus and Lithuania.

Chart 3: Financing patterns of non-financial corporations (in % of total liabilities)



Source: Eurostat, US Federal Reserve. Note: Loans include bank loans and intercompany loans.

Europe has traditionally been more reliant on bank finance, with bank lending playing a significantly larger role in the financing of the corporate sector than the issuance of debt securities in the market (Chart 3). In aggregate, this greater **dependence on bank lending** makes the European economy more vulnerable when bank lending tightens, as happened in the financial crisis.

Access to capital markets differs greatly across firms and across EU Member States. There has been a notable increase in the issuance of corporate bonds by non-financial corporates in the EU, partly reflecting a favourable market environment for bond issuers due to low interest rates. Bonds have, however, mainly been issued by large firms as opposed to small and medium-sized enterprises (SMEs). Bond issuance has also been **concentrated in larger markets**, rather than markets where corporate funding problems have been most severe.

Although capital markets in the EU became more integrated prior to the crisis in terms of cross-border holdings of financial instruments, the crisis revealed that part of this integration was driven by debt-based wholesale banking flows which were prone to sudden reversals in the face of shocks. **Equity markets in the EU remain characterised by a home bias,** meaning that potential risks and rewards are not shared across borders. Cross-border holdings of debt securities also remain lower than would be expected in a fully integrated market. Even the best performing national markets in the EU **lack critical size**, leading to a smaller investor base and fewer financial instruments to choose from.

2.2 Challenges and opportunities of building a Capital Markets Union

There are a range of different obstacles to the integration and development of EU capital markets, which originate in historical, cultural, economic and legal factors, some of which are deep-rooted and difficult to adjust. These include, for example, businesses' historical preference for certain means of financing, the characteristics of pension provision, the application of prudential regulations and administrative hurdles, aspects of corporate governance and company law, data gaps and features of many tax systems. Even in well-integrated capital markets some of these differences will remain. In order to achieve the benefits of a fully integrated single market for capital, it is necessary to overcome challenges in particular in the following three key areas.

First, on the supply side, the development of capital markets in the EU will depend on the flow of funds into capital market instruments. **Boosting the flow of institutional and retail investment** into capital markets would **promote the diversification of funding sources**. Growing private pension provision in Europe could result in an increased flow of funds into a more diverse range of investment needs through capital market instruments and facilitate a move towards market-based financing. Enhancing the confidence of retail investors in capital markets and financial intermediaries could increase the flow of household savings into capital market instruments which are now largely held in home equity and bank deposits. Increasing the global competitiveness and attractiveness of European capital markets in this way could also boost the flow of investment.

Second, achieving bigger, more integrated and deeper capital markets will depend on overcoming the barriers that are fragmenting markets and holding back the development of specific market segments. **Improving the investment chain to enhance cross-border investment and access to capital markets** would enable the EU to achieve the benefits of greater market size and depth. These include more competition, greater choice and lower costs for investors as well as a more efficient distribution of risk and better risk-sharing. More integrated capital markets, especially for equity, would enhance the shock-absorption capacity of the European economy and allow more investment without increasing levels of indebtedness. Well-functioning capital markets will **improve the allocation of capital** in the economy, facilitating entrepreneurial, risk-taking activities and investment in infrastructure and new technologies.

Third, on the demand side, **improving access to finance, including to risk capital, notably for SMEs (for example innovative and high growth start-ups)**, is an important priority. Success over time will depend on overcoming information problems, the fragmentation of key market segments and lowering the costs of access to capital markets. In addition, there are specific impediments to the financing of long-term projects, including infrastructure investment.

Section 3: Priorities for early action

The Commission has identified a number of areas where the need for progress is widely recognised, that have potential to bring early benefits. This Section outlines these initiatives and seeks views from interested parties on specific elements of each area.

3.1 Lowering barriers to accessing capital markets

The prospectus is one of the gateways into capital markets for firms wishing to offer transferable securities to the public or to have them admitted to trading on a regulated market. It is crucial that it does not act as an unnecessary barrier to the capital markets. The Commission will **review the current prospectus regime through a specific public consultation** launched in parallel to this Green Paper, with a view to making it easier for companies (including SMEs) to raise capital throughout the EU. A key focus will be to alleviate unnecessary administrative burdens for companies raising capital across the EU, looking at when a prospectus is required, whether all prospectuses need to be approved and streamlining the approval process, and simplifying the information included in prospectuses.

3.2 Widening the investor base for SMEs

Access to finance by SMEs has suffered more than that by larger companies in the crisis. Typically, information on SMEs is limited and usually held by banks, so SMEs struggle to reach the broader investor base of non-bank investors. Improving credit information would help build an **efficient and sustainable capital market for SMEs**. The development of a common minimum set of comparable information for credit reporting and assessment that is equally accessible by all interested parties could contribute to fostering the efficiency and integration of SME funding markets. In addition, standardised and continuous credit quality information could help the development of financial instruments to refinance SME loans, such as SME securitisation.

Work on **credit scoring** has started and received broad support from Member States. Credit scoring provides investors and lenders with information on the creditworthiness of SMEs. However, in Europe, around 25% of all companies and around 75% of owner-managed companies do not have a credit score. Possible action in this area could help diversify the financing of innovative and high growth start-ups. The Commission plans to hold workshops on SME credit information in 2015 to take forward this work.

3.3 Building sustainable securitisation

Securitisation, the process by which assets such as mortgages are pooled together for investors to invest in, can provide a powerful mechanism for transferring risk and increase capacity for banks to allow further lending to the economy. However, since the crisis, and despite low loss rates in European securitisations, activity has remained impaired. Securitisation issuance in Europe in 2013 amounted to some €180 billion (of which more than half was retained rather than transferred), compared to €594 billion in 2007.[4] A sustainable EU securitisation market relying on **simple, transparent and good quality securitisation** instruments could bridge banks and capital markets.

[4] AFME Securitisation Data Report, Third Quarter 2014

With the Solvency II and Liquidity Coverage Ratio delegated acts, work has already started to ensure a comprehensive and consistent prudential approach for highly transparent, simple and good quality securitisation. In addition to these initiatives, central banks, regulators, national authorities and private sector representatives have advocated a more **comprehensive approach to securitisation in the EU.**

For investors, an EU wide initiative would need to ensure high standards, legal certainty and comparability across securitisation instruments through a higher degree of standardisation of products. This framework should increase the transparency, consistency and availability of key information, particularly in the area of SME loans, and promote deep and liquid secondary markets to facilitate both issuance and investments. **The Commission services will consult on specific measures to meet these objectives.**

3.4 Developing European private placement markets

One way for firms to raise funds is via private placements, where a company makes an offering of securities to an individual or small group of investors not on public markets. These can provide a more cost effective way for firms to raise funds, and **broaden the availability of finance for medium to large unlisted companies and potentially infrastructure projects**. They also have the potential to offer additional investment opportunities for long-term investors.

Mid-sized European companies have been accessing the US private placement market for many years, raising $15.3 billion in 2013.[5] Since the onset of the financial crisis, the popularity of private placements has accelerated in Europe and some Member States have developed private placement markets. In particular, the German and French domestic private placement markets provided some €15 billion of debt in 2013. Barriers to the development of pan-European markets include insolvency laws, lack of standardised processes, documentation and information on the credit worthiness of issuers.

A consortium of industry bodies have established a market guide on common market practices, principles and standardised documentation for private placements, compatible with a diversity of legal frameworks. This guide should be available from Q1 2015 with first issuances following shortly thereafter. Having carried out a mapping of best practices in Member States, the Commission welcomes this market-led approach, which could help to facilitate the creation of a pan European private placement market in the short term.

3.5 Boosting Long Term Investment

Investment levels in the EU have fallen significantly from their 2007 peak and remain below their historical norm. The European Commission has already announced an Investment Plan that will unlock public and private investments in the economy of at least €315 billion over the next three years. In that context, a new European Fund for Strategic Investments (EFSI) is being set up[6]. In addition**, the European Long-Term Investment Funds (ELTIFs) regulatory framework** will allow investors to put money into companies and projects for the long term. ELTIFs should have particular appeal to investors such as insurance companies or pension funds which need steady income streams or long term capital growth. **Views are**

[5] See ICMA Q3 2014 report.

[6] Proposal for a Regulation of the European Parliament and of the Council on the European Fund for Strategic Investments and amending Regulations (EU) No 1291/2013 and (EU) No 1316/2013, COM(2015)10 final, 13.1.2015

welcome on what further role the Commission and Member States could play in encouraging the take up of ELTIFs, including the possible extension to ELTIFs of advantages currently available for national regimes, or encouraging European institutions such as the European Investment Bank (EIB) to use ELTIFs as channels for financing. ELTIFs could also complement the EFSI as a way to channel project funding.

Questions

1) Do you agree that these should be the priority areas for further short term work? What other areas should be prioritised?

2) What further steps around SME information could support a deeper market in SME and start-up finance?

*3) What support can be given **to ELTIFs** to encourage their widespread use?*

*4) How can the EU take steps to support the development of **private placement** markets in the European Union? By supporting market-led efforts to agree common standards or through regulatory action?*

Section 4: Measures to develop and integrate capital markets

In order to achieve the benefits of a fully integrated single market for capital, it is necessary to overcome challenges in particular in the following three key areas:

- improving **access to financing** for all businesses across Europe (in particular SMEs) and investment projects such as infrastructure.

- **increasing and diversifying the sources of funding** from investors in the EU and all over the world; and

- making the **investment chain** linking investors to those who need funding more efficient and less costly, both within Member States and cross-border.

4.1 Improving access to finance

There are important frictions in the flow of finance, in particular to SMEs. These funding problems are particularly pronounced in the countries that have been most affected by the crisis. There is also a lack of funding for infrastructure projects.

SMEs have traditionally been primarily dependent on bank finance. In the crisis, bank lending decisions inevitably became more selective, on the grounds of both banks' own balance sheet constraints and the rising default probabilities of borrowers. While capital markets can complement the role of bank lending for SMEs, their diversity and scant credit information is often better suited to relationship based lending, given the fixed-cost nature of sourcing and monitoring rather small and mostly local firms.

Alternative funding sources have an important role, in particular for **start-ups and smaller but rapidly growing firms in innovative industries**. These firms typically display initially low levels of cash flows and are dependent on external finance to grow their business. Bank finance, as well as other financing tools such as leasing and factoring, are often difficult to access or insufficient for companies with significant intangible assets that cannot easily be used as collateral to obtain bank loans.

Access to public capital markets is costly not only for SMEs, but also for **mid-cap firms** that may well be more likely than SMEs to tap public markets to raise funds. IPOs and debt underwriting are characterised by substantial fixed costs generated by due diligence and regulatory requirements, which may present a disproportionate burden for smaller firms. This includes the costs of disclosing information required by investors or regulators and meeting other corporate governance requirements. In the case of debt underwriting, there are the costs of commissioning an external rating. In addition, companies may be at an early stage of development and may have a commercial interest in not disclosing detailed information about their business plan. They may be reluctant to give up control or face greater external scrutiny. These features often preclude small and mid-caps from obtaining access to more standardised public equity and debt markets, leading them mainly to private debt and equity markets that are generally less standardised, more complex, and often more selective and expensive.

Large corporates generally have sufficient size to warrant the fixed costs of tapping capital markets and are big enough so that each individual issuance is sufficiently large to attract the attention of underwriters, investors and analysts. However, while issuance of corporate bonds has increased significantly over recent years, partly compensating for the decline in bank lending, issuance of quoted shares has remained subdued in Europe.

Finally, the EU requires a significant amount of **new infrastructure investment** to maintain its competitiveness. However, the flow of funds to such projects is restricted by short-termism, regulatory barriers and other factors. Also, many infrastructure projects display characteristics of public goods, implying that private financing alone may not be appropriate to deliver the optimal level of investment. While the EFSI will make an important contribution to boosting investment in infrastructure projects, the Commission welcomes views on other means of achieving this goal.

Addressing information problems

In Europe, most SMEs only approach banks when seeking finance. Although almost 13% of these applications are rejected, it is often because they do not always meet the banks' desired risk profiles, even if they are viable. Although banks sometimes refer SMEs on to alternative finance providers, this does not always work as neither banks nor SMEs are sufficiently aware of the existence of alternatives. Banks could be encouraged to provide better feedback to SMEs whose credit applications are declined and to raise awareness about alternative financing opportunities for SMEs whose credit was declined.

International Financial Reporting Standards (IFRS) have played a key role for promoting a single accounting language in the EU, making it easier for large listed EU companies to have access to global capital markets. However, imposing full IFRS on smaller companies[7], in particular those wanting to access dedicated trading venues, would be a source of additional cost. The development of a simplified, common, and high quality accounting standard tailored to the companies listed on certain trading venues[8] could be a step forward in terms of transparency and comparability, especially for SMEs, making such companies more attractive to cross-border investors. The standard could become a feature of SME Growth Markets, and be available for wider use.

The transparency of infrastructure projects or pipelines could increase their attractiveness for private investment as well as help regulators adopt a more tailored prudential regime for infrastructure investments. The Investment Task Force Report of 9 December 2014 suggested as a solution the creation of a central EU-level website to provide links to the Member States projects/pipelines and include EU project information (e.g. under the Connecting Europe Facility and European Structural and Investment Funds). Strategic long-term investment plans as well as project pipelines could be published by Member States on dedicated websites, (e.g. the UK has already published on a website its national infrastructure pipeline) while respecting confidentiality.

Standardisation as a mechanism to kick start markets

Although standardisation is not without risks, some markets can be kick-started with a common set of market rules, transparency on product features and consistent supervision and enforcement. A certain degree of standardisation, to encourage transparency and consistency, may attract more investors and increase the market depth and liquidity. This is particularly the

[7] For instance, companies with securities admitted to trading on the Alternative Investment Market (AIM) of the London stock exchange are not subject to the EU IAS Regulation. The AIM has adopted a rule that requires AIM companies to submit IFRS financial statements starting in 2007.

[8] Multilateral trading facilities (MTFs)

case in smaller Member States where markets cannot reach minimum efficient size if restricted to domestic pools of capital. Where common standards are not necessary or difficult to achieve, policy efforts may instead be directed to establishing best practices across the EU to promote the development of certain financial instruments.

The development of a more **integrated European covered bond market** could contribute to cost-effective funding of credit institutions and provide investors with safe and liquid investment opportunities. The success of covered bonds as funding instruments is closely linked with the development of dedicated national legal frameworks, but these markets remain largely national. The Commission will consult in 2015 on the merits and potential shape of an EU covered bond framework and present a range of policy options to achieve greater integration in covered bond markets. The Commission will also reflect on whether investors should be provided with more information about the collateral underlying covered bonds and other structured debt, similar to loan data disclosure requirements on structured finance instruments.

Despite the recent growth in **corporate bond** issuance, it is characterised by low levels of standardisation and price transparency. Although in recent years new electronic bond trading platforms aimed at retail investors have emerged in some Member States, a lack of standardisation may inhibit the development of bond trading venues and of a liquid secondary market. Greater standardisation of corporate debt issuances could allow for a more liquid secondary market for corporate bonds to develop. The Commission would welcome views on whether the possibility of developing a more standardised corporate debt market should be explored further, and whether this can best be achieved by a market led initiative or regulatory intervention.

Another emerging investment category with potential to attract further investment in the EU is that for environmental, social and corporate governance investments, such as **green bonds**. Green bonds are instruments in which the proceeds will be exclusively applied towards projects and activities that promote climate or other environmental sustainability purposes. The rapid growth in this market is being assisted by a market-driven standardisation process that takes into account criteria for green bond selection developed by, among others, the World Bank, the European Investment Bank and the European Bank for Reconstruction and Development. Market participants are currently developing voluntary guidelines, known as 'Green Bond Principles', that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance of a green bond.

Enabling alternative means of financing to develop

Although the online nature of crowdfunding would suggest great potential to contribute to the financing of the economy across national borders, there is very little cross-border or pan-European activity. As a follow-up to the Communication on Crowdfunding[9], the Commission is gathering information on industry approaches to information disclosure and Member State approaches to regulation. The preliminary results suggest that the diverse national approaches in these areas may encourage crowdfunding activity locally, but may not be necessarily compatible with each other in a cross-border context.

[9] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Unleashing the potential of Crowdfunding in the EU, COM (2014) 172 final of 27.3.2014.

Questions

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

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

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

8) What is holding back the development of risk capital markets? What lessons can be learned from countries where such markets are more developed?

9) Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of an SME growth market? If so, under which conditions?

10) Are there barriers to the development of crowdfunding platforms including on a cross border basis?

4.2 Developing and diversifying the supply of funding

The size of capital markets ultimately depends on the flow of savings into capital market instruments. Thus, for capital markets to thrive, they need to **attract institutional, retail and international investors**.

Boosting institutional investment

The role of long-term institutional investors in capital markets has been growing significantly. Regulatory barriers and other factors can, however, restrict the flow of long-term institutional investment to long-term projects, including investment in infrastructure.

With assets under management of more than €11 trillion, the **European fund management industry** plays a pivotal role in channelling investors' money into the economy. A great deal of this success is the direct result of Europe's investment funds frameworks. The **UCITS (Undertakings for Collective Investment in Transferable Securities)[10] framework for mutual funds** is a recognised international standard, while the **Alternative Investment Fund Managers Directive (AIFMD)** has created a framework within which European alternative investment managers are able to operate.

[10] Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

The regulatory cost of setting up funds, becoming authorised managers and selling them across borders, currently varies between Member States. Reducing costs for setting up funds, and cross border marketing more generally, would lower barriers to entry and create more competition. Alongside new entrants, it is also important that funds can grow and benefit from economies of scale. The Commission would welcome views on what further policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, such as long-term projects, start-ups, and SMEs.

The pensions and insurance sectors also hold significant assets of around €12 trillion which can help to fund investment. The new prudential regime that will apply to **insurers** from 1 January 2016, (Solvency II) will allow companies to invest more in long-term assets by removing national restrictions on the composition of their asset portfolio.[11] Furthermore, the Commission has ensured that the standard formula to calculate insurers' capital requirements does not impose obstacles to long-term investment and matching long-dated liabilities with long-dated assets[12]. While this effort was welcomed, some have called for a tailored treatment of **infrastructure investments**, in relation to the calibration of the capital requirements of insurers and also of banks. **Further work is needed to identify lower-risk infrastructure debt and/or equity investments, with a view to a possible review of prudential rules and the creation of infrastructure sub-classes.**

On **personal pensions**, the diverse array of providers (banks, insurers, asset managers, and others) are subject to a number of different pieces of EU legislation. This raises the question of whether the introduction of a standardised product, for example through a 29th regime, or removing the existing obstacles to cross-border access while also ensuring an effective degree of consumer protection, would strengthen the single market in personal pension provision.

As an alternative form of funding to traditional bank loans or listing on regulated stock markets, **private equity and venture capital** play an important role in the European economy. Private equity and risk-capital markets lack scale; this is the case not only for the stock exchanges specialised in financing high-growth companies, but also for risk-capital investment at the start-up or development stage of new enterprises or in high-technology companies. There is also a wide variation in the development of risk capital markets among Member States: around 90% of all venture capital fund managers are concentrated in eight Member States.[13]

In some Member States, venture capital funds face problems reaching the scale they need to spread their portfolio risk. The lack of an equity investment culture, informational problems, a fragmented market and high costs are among the main reasons for this. Moreover, in 2013 almost 40% of investments in Venture Capital funds came from public sources (up from around 15% in 2007).

In an effort to **promote the provision of risk capital** in the form of equity participation or loans to start-ups and social business, the EU adopted in 2013 the EuVECA (European

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[11] Separately, in the area of bank prudential regulation, the Commission Delegated Act on Liquidity Coverage Ratio (LRC), currently being scrutinised by the European Parliament and Council, will provide increased incentives for investments in infrastructure and SMEs (including a particular deduction for credit risk on exposures to SMEs, and specific provisions on high-quality securitisations) that would facilitate investments into SMEs.

[12] http://europa.eu/rapid/press-release_MEMO-14-578_en.htm

[13] UK, Germany Sweden, Denmark, Finland Netherlands, France and Spain.

Venture Capital Funds)[14] and EuSEF (European Social Entrepreneurship Funds)[15] Regulations. It has been suggested that one reason preventing wider take-up of these funds is that managers whose portfolio exceeds €500 million cannot apply to set up and operate such a fund, nor can they use these designations to market the funds in the EU. Widening the range of market participants could potentially increase the number of EuVECA and EuSEFs available.

Public funding can also play a role, with regional authorities being significant funders of venture capital in several Member States. **EU financial instruments such as the Competitiveness and Innovation Framework Programme (CIP)** have been successful in mobilising venture capital for SMEs, and the COSME[16] and Horizon 2020 programmes will build on its achievements. The question is how to increase the scale of venture capital funds, and how public and private funding together could contribute to this.

The lack of exit opportunities for investors may also be an obstacle to the development of venture capital funding. The Commission is interested to know whether measures can be taken to create **a better environment for business angels, venture capital and initial public offerings to ensure better exit strategies for investors and boost the supply of venture capital to start-ups.**

Banks are likely to remain key actors and participants in capital markets, as issuers, investors and intermediaries, and will continue to play a major role in credit intermediation through their role in funding and information provision. At the same time, new technologies and business models are emerging, such as peer-to-peer lending or other types of non-bank direct lending, which seek to offer funding to SMEs and start-ups. The Commission welcomes views on **whether there are significant barriers to entry to providing and growing these services.**

Questions

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

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

[14] Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds

[15] Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds

[16] Regulation (EU) No 1287/2013 of the European Parliament and of the Council of 11 December 2013 on establishing a Programme for the Competitiveness of Enterprises and small and medium-sized enterprises (COSME) (2014 - 2020) and repealing Decision No 1639/2006/EC

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

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

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

16) How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors? What impediments are there to safely growing non-bank direct lending?

Boosting retail investment

Retail investors' appetite for investing directly in marketable financial instruments is small across the EU, being predominantly channelled through collective institutional investments. However, European households have significant savings held in bank accounts that in some cases could be used more productively. Declining deposit rates may provide some incentives for households to shift more of their financial wealth from banks into market securities.

Mutual funds products such as UCITS are currently the most popular vehicles for retail investors to invest in capital markets. Despite this, the rate of direct retail participation in UCITS remains relatively low: private households only account for 10% of UCITS investors. To ensure a wider choice among investment fund products and increased competition, the Commission would be interested in views on ways in which **cross-border retail participation in UCITS could be increased**.

Retail investors will only be attracted to invest in capital markets if they trust them as well as the financial intermediaries operating in them, and believe they can safely secure a better return on their savings. Restoring the trust of investors is a key responsibility and challenge for the financial sector, and the impact of scandals – such as mis-selling – cannot be understated. Strengthening financial literacy would also enable consumers to choose financial products more effectively and easily, and compare products. There are a number of national programmes in place to improve financial literacy and education, as well as the EU project "Consumer Classroom." In some cases more standardised or simple financial products, which are available in some Member States, might also be useful.

Regulation and supervision can help to build confidence. The European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) have been given increased powers on investor protection through MIFID II and PRIIPs. As mentioned in the recent Commission review of the ESAs[17], their mandates in the area of consumer/investor protection could be clarified and enhanced where necessary.

[17] Report from the Commission to the European Parliament and Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS), COM(2014) 509 final.

Experience from the telecommunications and airline sectors would seem to suggest that **enhancing cross-border competition in retail financial services** could bring greater choice, lower prices and better services. **Financial services provided by electronic and mobile tools** have potential to contribute in this regard, provided that concerns over guarding against fraud, hacking and money laundering can be addressed while maintaining ease of use for customers. The Commission will begin preparatory work on how the single market for retail financial services can deliver more benefits to consumers.

Questions

17) What can be done to unlock household savings, where appropriate, and safely channel them into investment?

18) How can cross border retail participation in UCITS be increased?

19) How can the ESAs further implement their mandate to ensure investor protection?

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

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

Attracting international investment

European capital markets must be open and globally competitive, well regulated and integrated to attract foreign investment, which means maintaining high EU standards to ensure market integrity, financial stability and investor protection. The Commission is actively contributing to international work on freedom of movement of capital, including for example the enforcement of the OECD Codes of Liberalisation of Capital Movements.

In addition to incentivising the flow of European savings into capital market instruments, there is the question of whether more can be done to attract investors from outside the EU. According to International Monetary Fund (IMF) data, at the end of 2013 the global total stock of cross-border portfolio investments was €25 trillion. The total stock of cross-border portfolio investments between EU Member States was €9.6 trillion, whereas portfolio investments coming from outside the EU amounted to €5 trillion. Therefore, there is still a wide scope for attracting additional equity and debt investment from third countries.

While the post-crisis downscaling of gross capital flows affected all regions, the EU (and the euro area in particular) has undergone the most sizeable decline in the magnitude of gross capital inflows and outflows as a percentage of GDP. All components of gross capital inflows (portfolio investment, foreign direct investment, and bank intermediated claims) were lower in 2013 than in 2007. In light of these trends, the Commission is interested in views on measures that could be taken to increase the attractiveness of EU markets to international investors.

Questions

22) What more can be done to ensure that the EU is internationally competitive and an attractive place in which to invest?

23) What measures can be taken to facilitate market access of EU firms in third countries?

4.3 Improving the investment chain – intermediaries, infrastructures and the broader legal framework

Single rulebook, enforcement and competition

The development of a single rulebook in recent years has been a major step towards a more harmonised regulatory framework for capital markets in which firms can compete cross border on a level playing field. The success of the single rulebook also depends on the effective implementation and consistent enforcement of the rules. There are still some key pieces of EU legislation which allow for the addition of requirements, so-called 'gold-plating' by Member States, and issues of divergent interpretations of rules have also arisen. The Commission, in cooperation with Member States and the ESAs, is working to ensure that EU financial legislation is fully implemented and correctly enforced on the ground. The Commission will continue to ensure that competition law is rigorously applied to avoid restrictions or distortions of competition affecting the emergence of integrated and well-functioning capital markets.

The principle of free movement of capital should be enforced to tackle unjustified barriers to investment flows within the EU. For instance, requirements imposed by host Member States on market operators such as cross-border risk capital providers with a European marketing passport granted by their home Member State could in some cases constitute an unjustified barrier under the principles of free movement of capital. Furthermore, rules regarding the entry and operation of cross-border investments are fragmented across the Single Market. A more stable, transparent and predictable framework for investors would contribute to building confidence and enhancing the attractiveness of the Single Market as a place to invest for the long term.

To that end, a framework could be envisaged to govern the treatment of cross-border investment between Member States which could codify or clarify the existing EU rules which have an important bearing on investors when they operate cross-border in the single market.

Supervisory convergence

Although regulatory frameworks for capital markets have largely been harmonised, the success of reforms also depends on the implementation and consistent enforcement of the rules. The Commission, in cooperation with Member States and the European Supervisory Authorities (ESAs), works to ensure that EU financial legislation is fully implemented and correctly enforced on the ground. The Commission recently published a report on the operation of the ESAs and the European System of Financial Supervision (ESFS)[18] that identified a number of areas where possible improvements could be made in the short and medium term.

[18] COM(2014) 509 final.

The ESAs therefore have an important role to play, continuing to build on their contribution in fostering greater supervisory convergence, increasing the focus on and use of peer review and appropriate follow-up. Furthermore, active use of dispute settlement where it is needed and investigatory powers in relation to alleged breaches of EU law could facilitate consistent implementation and application of EU law across the single market.

In the context of capital markets becoming increasingly integrated, further consideration could be given to the role played by the ESAs. To the extent that national supervisory regimes may result in differing investor protection standards, barriers to cross-border operations and discouraging companies seeking financing in other Member States, there may be a further role for the ESAs to play in increasing convergence.

Data and reporting

The development of common data and reporting across the EU could help to support closer capital market integration. For example, a consolidated tape is essential to ensure the quality, availability and timeliness of post-trade information in a consolidated format. Should market-led efforts prove to be insufficient to deliver a consolidated tape which is easily accessible and usable for market participants on a reasonable commercial basis, consideration will need to be given to the appointment of a commercial entity operating a consolidated tape by way of a public procurement process. The Commission will also seek to ensure that the dissemination of consolidated information at commercially reasonable terms takes place unhindered.

More efficient approaches towards supervisory and market reporting, for example to develop common IT approaches for certain reporting requirements in EU legislation involving national authorities or ESMA, could be helpful for market participants. Views would be welcome as to whether further work is needed to improve data and reporting in the EU.

Market infrastructure and securities law

The regulatory framework that applies to the infrastructures that support trading and post-trading in financial markets is in the process of being put into place, with the adoption of EU legislation to ensure the robustness of central counterparties (CCPs) and central securities depositories (CSDs), and efforts to tackle market fragmentation through the CSD Regulation and the Target2Securities (T2S) project run by the Eurosystem. To complement this, the Commission intends to bring forward a legislative proposal to create a European framework for the recovery and resolution of systemically relevant financial institutions such as Central Counterparties. There are, however, some aspects relating to market infrastructures supporting trading where there may be potential to make further improvements.

Collateral is a vital part of the financial system as it provides a safety net in case there are problems. The fluidity of collateral throughout the EU is currently restricted, preventing markets from operating efficiently. Since the financial crisis, the demand for collateral has increased, driven by market demand for more secured funding as well as new regulatory requirements, such as EMIR and CRR. With demand for collateral rising, there are risks that the same securities are being reused to support multiple transactions as was the case pre-crisis and work is underway internationally to look at these issues. **Views are welcome as to whether work should be undertaken to remove barriers to facilitate the flow of collateral throughout the EU**.

Also, while there has been considerable progress in harmonising rules needed for the transparency and integrity of securities markets, **legislation relating to investors' rights in securities differs across countries**. As a result, investors have difficulties assessing the risk of capital investments in different countries. Discussions on this issue date back more than a decade starting with the Second Giovaninni Report in 2003. This issue is, however, complex as it touches on property, contract, corporate and insolvency law, as well as the laws on holding of securities and conflict-of-laws. Opposing views hold that harmonisation at EU level and a single EU definition of securities would not be necessary. Furthermore, it is argued that the launch of Target 2 Securities in mid-2015 will remove the legal and operational risks associated with the transfer and holding of securities across jurisdictions, reduce costs and could increase cross-border investment. In light of these constraints, **views would be welcome as to whether any targeted changes to legislation on securities ownership rules that could materially contribute to more integrated capital markets within the EU are feasible and desirable.**

Banks play a key part not only in bank lending but also in capital market intermediation, notably by providing liquidity through market making. Some research indicates signs of liquidity decreasing in some market segments, but also stress that liquidity may have been underpriced in the run-up to the crisis. The decline in liquidity is attributed by some to a necessary market correction as well as a decline in market confidence in the aftermath of the crisis, and by others to global post-crisis regulatory measures. The Commission is interested in views on how to achieve better priced and robust liquidity conditions, notably whether measures could be taken to support liquidity in vulnerable segments and whether there are barriers to entry for new market participants who can play a role in matching buyers to sellers.

Company law, corporate governance, insolvency, and taxation

There has been EU legislation in the area of **corporate governance** (e.g. on corporate governance statements[19], on the cross-border exercise of shareholder rights[20]), but corporate governance often remains a preserve of domestic law and standards. After the financial crisis a review of the EU corporate governance framework was undertaken through two consultations.[21] The revision of the **shareholders rights directive** that follows these consultations aims at encouraging institutional investors and asset managers to provide more long term capital to companies. This initiative will however only address parts of the concerns identified with respect to corporate governance due to the complexity of other issues.

The protection of **minority shareholder rights improves corporate governance and the attractiveness of companies for foreign investors**, since these may often be minority investors. Another aspect of sound corporate governance is the efficiency of company boards in terms of controlling company managers. As company boards protect the interests of investors, efficient and well- functioning company boards are also key to attracting investment.

Despite several existing Directives aiming to address the issue of cross-border mobility of companies[22], further **reforms to company law** might be useful as regards **rules on cross-**

[19] Directive 2006/46/EC
[20] Directive 2007/36/EC
[21] Green Paper on the corporate governance in financial institutions (COM(2010) 284 final) and Green Paper on the EU corporate governance framework (COM(2011) 164 final)
[22] Council Regulation 2157/2001 on the Statute for a European Company and Directive 2005/56/EC on cross-border mergers of limited liability companies.

border establishment and operation of companies as well **as rules on cross-border company mobility**. Divergent national **conflict-of-law rules** regarding the internal functioning of a company cause legal uncertainty, while those concerning the consequences for third parties of transfers of claims (assignment), for example in cases of insolvency, hamper cross-border financing instruments such as securitisation, factoring or financial collateral arrangements.

While the discussion around harmonising substantive insolvency legislation has been slow over the past 30 or so years due to its complexity, there has been considerable progress in the area of conflict-of-laws rules for cross-border insolvency proceedings.[23] The underlying national **insolvency frameworks** diverge in their basic features and in their effectiveness **between Member States**.[24] This divergence plays a part in hindering the emergence of pan-European equity and debt markets. In particular, this divergence creates uncertainty for investors needing to assess the risks in several Member States. Furthermore, the lack or inadequacy of rules enabling early debt restructuring in many Member States, the absence of second chance provisions, and the excessive length and costs of formal insolvency proceedings lead to low recovery rates for creditors and discourage investors. With a view to achieve progress on insolvency, the Commission adopted a Recommendation on a new approach to business failure and insolvency, an evaluation of which is planned for 2015.

Differences in tax regimes across Member States can affect capital markets, impede their integration and lead to sub-optimal geographical distribution of market participants. For example, differential approaches to taxation across Member States can create obstacles to cross-border mobility of and investments in certain financial products. Such differences can affect areas such as pensions and life insurance. As a follow-up to the White Paper on Pensions[25], the Commission conducted a study on the taxation of cross-border transfers of capital and cross-border payments of life pensions and insurance contributions, which led to a number of improvements for cross border investments by pension funds in shares and bonds. The Commission is now planning to examine the tax treatment of cross-border investments by life insurance companies and by pension funds in real estate. Work is also continuing on **simplifying withholding tax relief procedures related to post-trading**, inter alia in the light of the 2013 report of the Tax Barriers Business Advisory Group,[26] a feasibility study [27] and the OECD Treaty Relief and Compliance Enhancement ("TRACE") project.

In addition to differences in the tax treatment for different market participants across Member States, there are also differences in the tax treatment of different types of financing, which may create distortions. For example, the **difference in corporate tax treatment between debt- and equity-financing** might increase the reliance of companies on debt and bank funding. Furthermore, differences across Member States in the definition of debt and equity may hamper a level-playing field, fragment markets and create opportunities for profit-shifting.

[23] Regulation 1346/2000 on insolvency proceedings

[24] Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency C(2014) 1500 final, http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf

[25] The White Paper "An Agenda for Adequate, Safe and Sustainable Pensions" was adopted on 16 February 2012, building on the 2010 Green Paper consultation. The White Paper takes stock of the challenges to adequacy and sustainability of pension systems and puts forward a range of policy measures at the EU level.

[26] http://ec.europa.eu/internal_market/financial-markets/docs/clearing/tbag/130524_tbag-report-2013_en.pdf

[27] http://ec.europa.eu/taxation_customs/taxation/personal_tax/taxation_securities/index_en.htm

Finally, obtaining finance is especially difficult for start-ups as they lack collateral and a proven track record that can provide certainty to suppliers of financing. Such young start-up companies are, however, more likely to bring innovations that challenge the market position of large incumbent firms. A recent study commissioned by the European Commission[28] concluded that **targeting tax incentives for R&D expenditure** at young innovative companies is an effective practice.

Technology

One of the key drivers of the integration of capital markets is the rapid development of new technologies, which have contributed for example to the development of electronic trading platforms, high frequency trading and so-called "FinTech" companies. "Fintech" can be defined as the combination of innovative financial services and the availability of capital through the use of new (digital) technologies, such as crowdfunding. According to a recent report, global investments in FinTech increased from $930 million in 2008 to nearly $3 billion in 2013. In the UK and Ireland alone, FinTech companies received over $700 million from investors between 2008 and 2013[29].

European and national company law has not kept pace with technological development, for example by insufficiently **integrating the benefits of digitalisation.** Exchanges of information between companies, shareholders and public authorities are often still paper-based. For example, in many companies shareholders still cannot vote electronically and there is no Europe-wide on-line registration of companies. Use of modern technologies in these areas could help reduce costs and burdens, but also ensure more efficient communication, particularly in a cross-border context.

Questions:

24) Are there mechanisms to improve the functioning and efficiency of the investment chain not covered in this paper?

25) In your view, are there areas where the single rulebook remains insufficiently uniform?

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

27) What measures should the EU take to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

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

[28] http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_52.pdf

[29] Accenture report on FinTech (full reference to be supplied by DG CNECT)

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

30) Are there specific aspects of insolvency laws that would need to be changed in order to support the emergence of a pan-European capital market?

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

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

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

SECTION 5: NEXT STEPS

On the basis of the outcome of this consultation, the Commission will consider the appropriate actions needed to put in place by 2019 the building blocks for an integrated, well-regulated, transparent and liquid Capital Markets Union for all 28 Member States. In addition to supporting market-led initiatives where possible, where necessary EU action could take the form of non-legislative measures, legislation, competition enforcement action and infringements, as well as country specific recommendations to the Member States in the context of the European semester.

Interested parties are invited to send their answers to the questions in this Green Paper by [… 2015] through the **online questionnaire**:

During the consultation process, the European Commission:

- Will engage with the European Parliament to get direct feedback from its Members;
- Invites Member States to organise consultations and events with the public and national parliamentarians to promote discussion on Capital Markets Union at national level; and
- Will organise in a transparent and balanced manner workshops to consult those with specific technical expertise (such as academics, market participants) to reach an informed view on specific issues.

The Commission will organise a Conference in June 2015 to draw the conclusions of the consultation and discuss with all interested parties. An Action plan on Capital Markets Union will be published in summer 2015.