Banking & Payments Federation Ireland

The Next CMU – Recommendations to deepen and improve the Capital Markets Union

- *September 2019*

Introduction

Banking & Payments Federation Ireland (BPFI) is the voice of banking and payments in Ireland and represents over 70 domestic and international member institutions, many of whom operate in the Irish, European and Global capital markets.

BPFI welcomes the initiative taken by the Netherlands, France and Germany to establish a High-Level Group to report on recommendations for deepening the Capital Market Union (CMU). BPFI supports continued efforts at EU level to diversify financing, create deep and liquid markets and promote a large range of financing opportunities for firms and investors. The CMU Action Plan of 2014 under the Juncker Commission began a much-welcomed process with valuable initiatives, that should be continued as part of the incoming Commission's Strategic Agenda 2019-2024.

BPFI believes that a strong and well-functioning CMU will help bolster the EU's ongoing economic recovery and provide more diversified channels of funding and investment to SMEs, start-ups, corporates and EU citizens. The CMU initiative should therefore be seen as a complement to bank-based finance in Europe that can help support a resilient and sustainable EU banking sector.

We welcome the opportunity to contribute to the work of the High-Level group. In our response below, we have primarily **focused on Question 12** around the wider policy areas that need further attention from an EU 27 perspective but have also provided answers to other questions where relevant to the views of our Membership. BPFI understands that there are numerous competing priorities in the development of a CMU but would suggest the Group strive to prioritise the following:

- the role of retail investor in Capital Markets,
- the support Capital Markets can offer SMEs
- the benefits of enhancing the role of the Banking Sector in the CMU initiative; and
- the need for the EU27 to remain open and globally competitive

1. Which are currently the most competitive global financial centers / markets in the world? What would be the crucial elements for their success?

Crucial to the success of capital markets across the globe are informed and educated participants who:

- Are aware of the risks and benefits associated with it; and
- Possess the tools and mechanisms for accessing it

For this to be possible, an extensive **pan-European promotion programme** would need to be undertaken by all the stakeholders participating in it. A mindset and cultural shift would be required to achieve the type of scale in capital markets in Europe that we see in the US for example.

This could be achieved if the necessary financial education and awareness programmes are enhanced to better inform European citizens of **pan-European wide product offerings**, **regulatory sandboxes** and **funding propositions** in place. These would need to operate alongside a regulatory and legal regime which enables capital market activity and advances with technological change through close engagement with industry and key stakeholders.

The most competitive and efficient financial centres (based on volumes and make-up) globally are the US, EU 28, and Japan. These centres offer the deepest pools of liquidity and capital for both primary and secondary markets – whether that is around the ease and availability of making an initial public offering (IPO) to the use of different instruments for risk management purposes among other things.

The US' capital markets are the most diverse in terms of the range of services offered (e.g. equity, debt securities, and funds) and in terms of the extent that they are utilised by businesses. Despite progress made at EU level in terms of building the right environment for a capital market, the overall size of the EU's market remains much smaller compared to the US in terms of GDP (77% of GDP vs. 156% of GDP in the US). The UK makes up roughly 22% of the EU 28 market and therefore when the UK leaves the Union, a significant portion of the EU's current capital market will be within a third country.[1]

The UK's departure from the Union presents both challenges and opportunities for the EU27 and the incoming Commission around the future development of CMU, decisions which will shape the future of Capital Markets for EU investors.

2. Do you believe an EU 27 CMU will be able to compete on an equal footing with such global financial centers / markets? Has an EU 27 CMU sufficient access to global capital markets on its own, both on the sell side and on the buy side? Can you identify any significant strengths and/or weaknesses? Please specify.

3. Do you believe an EU 27 CMU develops the appropriate diversity of: financial products (Cash, derivatives, investment vehicles…)? Markets segments (Regulated, OTC)? Market

[1] CEPS-ECMI publication entitled: Rebranding Capital Markets Union: A market finance action plan, 2019. Link: http://www.eurocapitalmarkets.org/sites/default/files/rebranding_capital_markets_union_1.pdf

infrastructures (Trading, Post-trading)? Financial intermediaries? Service providers? What priorities would you set to achieve such diversity?

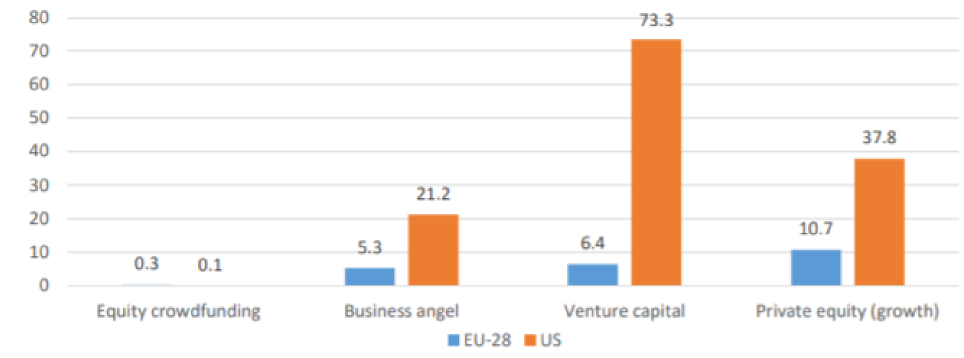
4. **Do you believe an EU 27 CMU can be seen as an integrated deep and liquid financial market with sufficient critical mass? Have you identified obstacles to a fluid Single Market? What priority measures could overcome fragmentation (corporate tax, insolvency laws…)? How do you assess the potential of digital technologies, infrastructures and in particular platforms to overcome the fragmentation of European financial markets?**

5. **Have you identified obstacles to financial markets consolidation in the EU 27? What would be the benefits? What steps could be taken to encourage more connections and cross border activity? Would this preserve/create a dense and varied EU wide Ecosystem?**

6. Does an EU 27 CMU provide an appropriate range of financing facilities for startups, upscaling businesses, SMEs and Midsized companies?

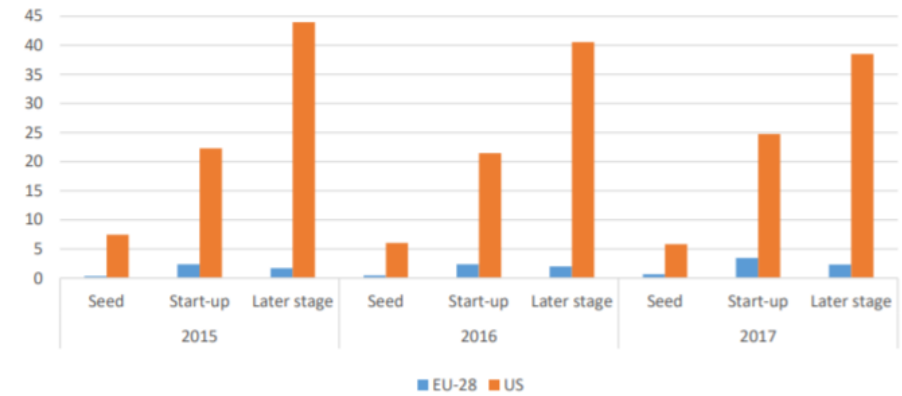
SMEs are the backbone of the European and Irish economies and represent 99% of all businesses in the EU[2]. A renewed effort and commitment is essential to ensure that SMEs have the necessary support to grow and scale-up, including adequate access to finance through capital markets. Unfortunately, at present European SMEs **find it more difficult to get access to financing** during pre-IPO stage and even once a company has started to scale from other sources of funding outside of bank finance (see below figure 1 & 2 for a comparison between the EU28 & US[3]).

Figure 1. Pre-IPO risk capital investments by asset class, EU-28 and US (end-2017, € billion)



Source: AFME (2018).

Figure 2. Venture capital investments by stage focus, EU-28 and US (€ billion)



Notes: VC seed investment refers to the funding provided before the investee company has started mass production/distribution with a view to completing research, product definition or product design. This type of finding will not to be used to start mass production/distribution. VC start-up investment refers to the funding provided to a company (once

Whilst private equity and venture capital is growing in Europe, it is clear from figures above that the **appetite from investors in the EU is less compared to that of the US**. This is primarily a result of a **difference in culture** – both from an investor and business perspective, with businesses often

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[2] European Commission website: https://ec.europa.eu/growth/smes_en

[3] CEPS-ECMI publication entitled: Rebranding Capital Markets Union: A market finance action plan, 2019. Link: http://www.eurocapitalmarkets.org/sites/default/files/rebranding_capital_markets_union_1.pdf

lacking information about other types of funding. Enhancing capital market access for SMEs is therefore key.

As a first step to support SME/start-ups compete against counterparts in other jurisdictions – and enhance knowledge of and access to more diverse types of funding at the early stage of their development – **we would welcome the development of a coherent strategy for SMEs to be coordinated across DGs in the European Commission** with specific initiatives aimed at ensuring ease of doing business within and across borders. Possible initiatives could include:

- The establishment of an **information hub for SMEs** to:
    - **a.** Assist companies during a pre-IPO stage to ensure that they are aware of how to enter public markets.
    - **b.** Act as a centre for building awareness for SMEs around accessing private funding (e.g. private placements).
    - **c.** Promote awareness of the benefits of specific financial products such as FX hedging as a tool to manage risk
- Encourage Member States to **establish Central Credit Registers** to hold information (e.g. credit data) on young companies so that investors can make informed decisions on the long-term growth potential.
- Further work on **developing an EU funding escalator for SMEs** through engagement with institutional and private investors
- Maintain the use of the SME supporting factor to support bank lending to SMEs and assess the possibility of creating a public **SME guarantees for bank loans** to enhance access to bank finance for SMEs.
- National **tax deferral schemes** for SMEs which would aim to reduce the taxable amount owed on equity in the businesses and help SMEs retain staff vis-à-vis larger tech companies.
- The creation of **venture capital schemes** that can offer tax relief to individuals to encourage them to invest in companies and social enterprises that are not listed on any recognised stock exchange. Specifically, we would welcome Member States to establish an **Enterprise Investment Scheme (EIS)** by offering tax reliefs to individual investors who buy new shares in an SME.

7. Do you consider Green (Climate neutral) finance is a priority? Which incentives would help promoting such kind of finance?

To meet the objectives of the Paris Agreement, and achieve the Sustainable Development Goals, involvement of the private sector is essential.

BPFI welcomes the European Commission Sustainable Finance Action Plan and specifically the development of an EU Taxonomy and is supportive of an assessment around the possibility of applying the taxonomy to green finance. The success of the taxonomy will be fundamental in helping the EU achieve its ambition to become a global leader in Sustainable Finance.

BPFI further notes the ongoing work at EU level by the European Banking Authority on the assessment of the prudential treatment of green and social assets and consultations to assess how to integrate sustainability-related financial risk into risk management frameworks and management practices. BPFI notes that discussions are also ongoing with regard to the development of a Sustainable Finance Supporting Factor to reduce capital requirements for certain eligible sustainable assets. We look forward to inputting into the discussions but would highlight that **no Supporting Factor should override the need to establish a thorough risk-based creditworthiness assessment.**

Other key areas we would like to see prioritised are:

- The creation of a specific **European Sustainable Finance Guarantee Fund** to provide guarantees to financial institutions to support sustainable lending and investments
- The development of an **EU Green Bond** market and specifically **"Green Covered Bonds"** where the issuances are collateralised by green or sustainable assets. In this regard, a clear definition of eligible assets would be welcome as would consideration of preferential prudential treatment where relevant.
- The development of a **European Green Loan Securitization Framework** could also further enhance ability to harness scale of smaller projects/loans – combined with a broader review of the current STS framework in Europe to make it more attractive. Please see additional information on this latter point under question 12.
- Use of **tax incentives** to create demand for Sustainable Finance Products.

8. What are the real break-through technologies that are likely to significantly change your business and create opportunities? How are you preparing for this?

Break-through technologies that are likely to change the operating environment for financial services companies and create opportunities include in particular the rise of Artificial Intelligence, Robo advisers, Distributed Ledger Technology, advanced data analytics, open APIs and the wider concept of RegTech. Efforts are underway by all BPFI members to assess the challenges and opportunities of adopting such technologies into their businesses to drive cost-efficiencies and create enhanced product offerings to consumers and clients. Of utmost importance in the success of the digitalisation of financial services will be how these break-through technologies are shared and scaled to ensure maximum reach and benefit for market participants including consumers.

9. Do you believe EU and national supervisors promote a more integrated CMU? In your area, how is supervisory efficiency best achieved (national, convergent, integrated)? Have you identified specific obstacles to more EU wide supervision?

10. What obstacles do financial intermediaries already engaged in cross-border activities meet, and what can be done to remedy this?

11. Will societal trends and evolutions, like ageing and digitalization, be disruptive and change your business? How are you preparing for this?

12. Which wider policy areas need further attention from a EU 27 CMU perspective (tax, insolvency, (financial) education…)?

BPFI would suggest the High-Level Group prioritises the following issues in its efforts to develop "The Next CMU":

- the role of retail investor in Capital Markets
- the support Capital Markets can offer SMEs

- the benefits of enhancing the role of the Banking Sector in the CMU initiative; and
- the need for the EU27 to remain open and globally competitive

The role of retail investors in Capital Markets: The development of an investor culture is crucial for Europe to grow its capital market.

BPFI believes a renewed and concerted effort with regard to **financial education** could be key to unlocking the potential and demand for capital markets in Europe, particularly given the current low interest rate environment, which offers a unique opportunity to promote the benefits of retail investors having a mixed portfolio of investments to secure their financial future.

Enhanced action around financial literacy and education is essential. Whether investing directly in equities or indirectly through their pension or investment funds, retail investors need firstly to understand the investment opportunities, the risks/rewards and have confidence in the liquidity of such assets.

The European Commission and Member States, mindful of the EU treaties, should take steps **to improve the level of financial education across all Member States** for retail investors so that investors better understand the functioning of capital markets, their role within the economy and how they could channel savings in order to benefit from activity on capital markets.

A concrete action that could be undertaken in cooperation between the European Commission and Member States is a **targeted educational campaign** to be coordinated by Member States together with the European Commission and European industry bodies around financial literacy, focussing on the **opportunities of capital market investment** for retail investors.

The support Capital Markets can offer SMEs: With regard to the support Capital Markets can offer SMEs, please see above answers to Question 6.

The benefits of enhancing the role of the Banking Sector in CMU: BPFI supports a more holistic approach to the promotion of banking and capital markets as a joint endeavour that strives to make the EU economy more resilient in the long-term. Member States and the European Commission should see the completion of both the Banking Union and Capital Markets Union as one complementary project that can help the entire financial system. Specific initiatives to be pursued to ensure that banks can effectively participate in capital markets include:

- **Revive the European Securitisation Market** by reducing many regulatory and operational constraints that at present disincentivize securitization issuances with issuance in Europe still at a fraction of the level it once was, having dropped from €819 billion in 2008 to standing at just €269 billion in 2018.[4] Securitisation is crucial for banks both as a funding tool and as a credit risk transfer mechanism to help deleverage balance sheet risk. Given the lack of uptake in securitisation since 2008, the European Commission could assess if further changes are required to boost the role of securitisation to ensure banks can lend to the real economy.
- **Strive to foster greater cross-border banking** and to reduce regulatory and supervisory obstacles. For example, capital and liquidity should be able to flow as freely as possible within

[4] AFME publication: https://www.afme.eu/en/news/views-from-afme/a-new-era-for-securitisation/

banking groups to avoid fragmentation. This also helps to support the economy from economic shocks by having the private sector take on board a larger portion of the risk sharing cross-border.

- **Further harmonisation of reporting frameworks** is urgently required, following recent regulatory reforms that have enhanced data reporting with several new reporting obligations towards the ECB, National Competent Authorities and the ESAs. While acknowledging the progress that has been made in the last legislative mandate (e.g. by changing reporting requirements under EMIR), there remain areas where market participants must satisfy overlapping and, often different, requirements. Consistent, high-quality reports are crucial for investors when they make their investment decisions and further efforts could be made to streamline these procedures in a horizontal manner. **BPFI would support any initiative to harmonise supervisory reporting frameworks across the financial service's regulatory framework** that would free up significant levels of capital and resources across the financial and non-financial sectors.

The need for the EU27 to remain open and globally competitive: The EU27 must seek to remain open and globally competitive in a world challenged by growing geopolitical tensions. The EU's equivalence framework enables EU businesses to have access to deep pools of liquidity and capital from third country jurisdictions and it is **crucial that Europe's equivalence requirements do not become more restrictive.** We would warn against the use of time-limited equivalence decisions as it creates uncertainty for market participants and would welcome more transparency and predictability in the entire equivalence process, particularly around the withdrawal of equivalence.

While there is a genuine need for Europe to develop a capital markets union and be globally competitive vis-à-vis other regions, this endeavour should not come at the expense of upholding the principle of open markets. As the FSB and IOSCO have noted recently in two separate studies, liquidity pools are becoming increasingly fragmented globally – resulting in rising costs of capital. Any closing of market access gateways or a tightening of market access rules should be avoided as far as possible. By being open to deep liquidity pools Europe will be able to build a competitive capital market.

13. EU households hold a large part of their financial wealth in the form of bank deposits. Accordingly, the demand for capital market products (shares, bonds, insurances, etc.) is (too) low. How can this change?

Please see answer to Question 12 and the specific point on Financial Education.

14. How can and should progress towards an efficient and competitive EU 27 CMU be measured? Would this help review measures already agreed?

15. Did we fail to ask something, you nevertheless find important to bring to our attention?

ENDS