Next CMU High-Level Group – Questionnaire

Having been supportive to the idea of deepening and further integrating the capital markets within the EU from the very beginning, BVI[1] feels that the original CMU project has fallen short of delivering to the full on the legitimate goals set out by the EU Commission in 2015.[2] Even though progress has been made, we commend the High-Level Group for its commitment to further work towards shaping and strengthening capital market-based investment and financing for the real economy in the EU27.

Regarding the questionnaire published on www.nextcmu.eu, we comment as follows:

1. **Could you provide us with an analysis of deep trends and developments (such as digital and artificial intelligence transformation, aging, climate change, UK's decision to leave the EU) relevant for the future of the Capital Markets Union? What is the impact of these trends on capital markets in Europe, its products and services? (Please provide data).**

   Digitalisation indeed must be considered a paradigm shift for the industry; see our answer to question 6. Climate change and the role of the financial industry in strive for a more sustainable economy will massively shape the future regulatory environment for our business. Apart from that, we see no fundamental societal trends and evolutions that would be disruptive and lead to fundamental changes.

2. **From a forward-looking perspective, how do you view strengths and weaknesses of the Capital Market Union in its current state and when made of 27 Member States? From the perspective of companies (all sizes and at each stage of their growth), consumers, (wholesale and retail) investors and other market players? How do you view the role of EU's and national supervisors? How does Brexit change the prospect for a financial integration in the EU?**

   There is no serious doubt that in theory, the EU27 CMU, just as the EU28 CMU, would be able to compete on an equal footing (albeit at smaller scale) with its peers like the USA. We also think that from a global perspective, the EU is being considered a stable and reliable financial centre and should be able to interact with other capital markets around the world on both the sell side and the buy side. However, the most important weakness of the EU27 CMU is the lack of awareness for the impact of regulation on the global competitiveness of the local financial industry. This deficit will have to be overcome in order to allow for competitiveness on equal footing.

   For many years the EU has been heralding its commitment to "better regulation". The result, however, is no less than disappointing. During the last three years alone, EU legislation with relevance to the fund sector has nearly doubled on all levels. The result is a huge pile of red tape,

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's more than 100 members manage assets of some 3 trillion euros for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 22% in the EU, Germany represents the largest fund market as well as the second fastest growing market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] See https://www.consilium.europa.eu/en/policies/capital-markets-union/

BVI
Bundesverband Investment und Asset Management e.V.
Kontakt
Fon +49 69 15 40 90 0
www.bvi.de
BVI Berlin
Unter den Linden 42
10117 Berlin
BVI Brüssel
Rue du Trône 14–16
1000 Bruxelles
BVI Frankfurt
Bockenheimer Anlage 15
60322 Frankfurt am Main
Geschäftsführung
Thomas Richter Hauptgeschäftsführer
Rudolf Siebel Geschäftsführer

leading to excessive compliance costs on behalf of the affected industry while the political goals were mostly missed or even thwarted. MiFID II and PRIIPs come to mind as negative examples. Legislators use the Lamfalussy procedure to avoid taking controversial decisions by delegating them to Levels 2 and 3, as has happened in PRIIPs. This is all the more unfortunate since the entities in charge of these procedures have to deliver within a – usually ambitious – timeframe set on Level 1, which usually comes at the expense of quality and leads to delays: both MiFID II and PRIIPs legislative procedures had to be extended because of this problem. Finally, even regulations meant to dismantle barriers and to reduce administrative burdens effectively resulted in new restrictions, implementing efforts and costs, such as the cross-border fund distribution initiative which – contrary to its objective – will likely add red tape to purely domestic operations, or the investment firms review which was meant to reduce and simplify prudential requirements for (small) investment firms but resulted in a much more complex and disproportionate framework.

EU legislators should take into account the distinct business model of asset managers and their respective products and services in comparison to other market participants such as banks when considering further regulation. The asset management sector is already subject to a detailed and robust specific regulatory framework at the EU level.

Concerning supervision, we consider the current allocation of roles between the ESAs and the NCAs adequately balanced in order to exploit the benefits of a CMU whilst preserving the strengths and specificities of the individual Member States. We therefore think that the ESFS review has rightly left this balance mainly untouched.

We see, however, a disconcerting tendency that ESAs try to expand their area of responsibility. In the previous years EBA has issued guidelines for CRD institutions on governance, delegation and remuneration. These guidelines are applicable at group level, meaning that CRD institutions must require other group entities which are not CRD institutions, e.g. management companies, to adhere to these guidelines. In other words, EBA is indirectly setting rules for non-banking institutions. This leads to additional compliance load for the entities affected as well as an uneven regulatory playing field with non-banking institutions which are not part of a banking group.

3. **Is European SME's financing satisfactory beyond bank finance? Why is access to capital markets (debt and equity) so difficult? Are there relevant differences between national financial markets in this respect? How could access to market financing facilities be improved for all size companies in each stage of their growth?**

While the range of financing facilities for smaller enterprises is basically satisfactory, MiFID II has impaired the efficiency of these facilities: The mandatory unbundling of trading commissions has massively reduced the availability of research for smaller, less known and less liquid enterprises. As a result, it has become much more difficult for asset managers to invest in such companies, and access to capital markets has become more difficult for smaller players.

4. **Home bias in investments still characterizes the EU landscape. What would you say are the main issues limiting cross border flows and what steps could be taken to encourage more cross border activity?**

From the perspective of the asset management industry, the various passports for cross border distribution and the cross border provision of services already work quite well.

5. **Are there obstacles for households to invest their long-term savings into capital market instruments (directly or through dedicated financial vehicles, like investment firms, pension funds, insurers …)? What can be done to overcome these impediments? Who should take such measures?**

An absolute precondition for directing savers' monies away from bank deposits to capital markets is a strict adherence to the principle of better regulation (see our answer to question 2 and 9) on all levels of financial services regulation alike. Unfortunately this has not been the case during the last years. To the contrary: While the CMU project tried to make retail investors' engagement in capital markets more attractive, other legislation taking place in parallel had exactly the opposite effect. According to an academic study conducted by the Ruhr-Universität Bochum[3], implementation of MiFID II had led to, inter alia, the following consequences in Germany:

- The vast amount of mandatory information according to MiFID II alienates and overburdens the retail investor.
- MiFID II has caused order placement by telephone to decrease by 50% due to mandatory recordings and impractical information requirements.
- The high degree of standardisation of advice under MiFID II undermines individuality and frustrates the clients.
- Contradictory information under MiFID II and PRIIPs can hardly be explained to customers and causes despair.
- Mandatory warnings in client information according to MiFID II and PRIIPs nurture retail clients' doubts that investments in capital markets might be a good idea.

In a nutshell, MiFID II and PRIIPs Regulation drive retail investor away from capital markets. Since none of the problems mentioned come with bank deposits, it is no wonder that retail investors stick to these inefficient and economically undesirable saving vehicles. If the EU really wants to make investments in capital markets more attractive, these flaws in existing regulation will have to be ironed out radically.

In addition, financial education is still a "blind spot" in the EU political agenda. It is absolutely essential to foster economic literacy among EU citizens on order to raise their awareness of economic effects and to qualify them for meeting the challenges of old age provision.

Taxes on financial transactions like the currently discussed financial transaction tax (FTT) in the framework of enhanced cooperation are contrary to the intention to make capital market products more attractive for retail investors. The FTT would not only lower the return for retirement savers but could also harm the capital markets of participating Member States. Instead of levying additional taxes on financial products by some Member States, all Member States should undertake efforts towards incentives in order to facilitate retirement savings (see also answer to question 7).

6. **Digital transformation and artificial intelligence are both causes for disruption and opportunities for innovation. How should the Capital Markets Union develop to provide a**

[3] https://die-dk.de/en/topics/press-releases/mifid-ii-driving-customers-away-capital-markets/

welcoming environment for startups and scale ups? and in the financial sector for FinTech? How to develop a dynamic ecosystem of financial innovation? Do you find the "sandboxes" and related initiatives useful? How can new technology support an efficient and sustainable functioning of Europe's capital markets? What are best practices?

The emergence of the three technologies namely distributed ledger technology (DLT), big data/artificial intelligence and cloud computing has the potential to lead to a fundamental change in the financial services industry. Asset Managers are currently assessing their options. However, regulatory barriers prevent the integration of some of the technologies. In order to realise the potential of new technologies in the asset management industry, we recommend the following:

- Create a legal framework for safe and secure digital issuance of securities to enable securities trading through blockchain technology. In this context, the legal nature of digital assets (crypto tokens) should be discussed on a European level to avoid deviating interpretations in cross border cases.

- The application of innovative technologies such as big data and artificial intelligence as well as cloud computing needs to be compatible with the supervisory regulatory framework.

- EU regulation shall treat providers of financial solutions by the principle of "same activity, same risk, same rules, same supervision" as the promotion of regulatory sandboxes increases competitive distortions.

7. **How should capital markets play a role about climate change and aging? How can this be organized in such a way that capital markets grow themselves as well and become more stable? How to bolster the Union's capacity to finance its sustainable growth and job creation?**

The transition to a more sustainable environment is one of the key challenges for Europe. A growing number of institutional investors and asset managers already select investments taking into account material ESG considerations throughout their portfolios. The dynamic of this development must not be impeded through overburdening, duplicative and inconsistent requirements. Market participants have to be able to move forward from their different starting points to prevent discouragement of engaging in sustainable finance.

Regarding aging, funds are the backbone of old-age provision and enable participation in economic growth. Hence, we welcome the inclusion of funds in the legislative work on the Pan-European Personal Pension Product (PEPP). The PEPP will foster an EU Single Market for personal pensions by addressing fragmentation between national markets, which currently prevents cross-border distribution of personal pensions and results in limited competition between providers, higher prices and an absence of portable personal pensions across Member States.

- The Commission and EIOPA shall provide reasonable regulation on Level 2, especially with a focus on costs/fees regimes and a level playing field for PEPP providers in the risk-mitigation technique context. The fee cap enshrined in Level 1 must be interpreted on Level 2 in a way that makes the PEPP economically viable.

- PEPP Level 2 measures should be developed in a way that the PEPP remains attractive for savers and providers alike. Consumer testing on the PEPP KID could deliver better outcomes in this respect.

- On a larger scale, EU institutions shall undertake efforts towards an EU-wide, tax-qualified defined contribution pension plan regime. By example, tax harmonisation has resulted in the so-called 401(k) pension plans in the United States to become extremely successful over the last decades.

- The adoption of a Retirement Savings Action Plan to encourage EU citizens to save more for their retirement. Such an Action Plan shall include the launch of an ‘EU Retirement Savings Week’ and the development of guidelines and tools to help EU citizens understand the impact of the ageing population on the level of public pensions by 2030 - 2040.

8. What are crucial elements for a well-functioning deep and liquid financial market within the EU27? How should the EU27 Capital Markets Union be structured to be a globally competitive and attractive financial market? How should the relations with financial markets in third countries be strategically shaped?

While MiFID II paved the way for setting up a Consolidated Tape (CT) for equity instruments, it has not been implemented yet. We welcome the current ESMA consultation assessing the functioning of a CT. A CT could resolve a lack of pre- and post-trade price transparency and provide an efficient pricing mechanism in line with the best execution compliance requirements.

We understand that the EU Commission as well as ESMA consider a mandated CT as a catalyst for handling the market data issues, as a CT may foster fair access to and prices for data provided by market data providers. We are supportive of a CT to the extent that it is properly constructed and governed. However, we are concerned that, if the users' demands regarding the governance and operations of the CT are not met, an inadequate set up of a CT could actually worsen the market data problems considerably. Users will not only have to finance the CT, but due to business and compliance requirements will be forced to continue to use the other market data sources as well. A CT as such will not solve the market failure in terms of market data costs – as is obvious when looking at the current problems in the US. Beyond market data provided by exchanges, benchmark providers and rating agencies should also be under scrutiny for their oligopolistic practices.

In addition, please see also answers to question 2 and 9.

9. What should be the 3 key priorities for the next phase of Capital Markets Union?

Priority No 1: Adding the missing pillar to regulation

On a global level, the European asset management industry is operating in an extremely competitive environment. EU fund providers are contending with their peers from non-EU jurisdictions for investment opportunities as well as for investors. This challenge remains virtually unrecognised in current EU regulation which largely focuses on consumer protection and systemic risk. Neither the EU Commission nor the ESAs as representatives of the executive branch have a mandate to consider the competitiveness of the domestic industry as a factor in performing their duties. This has resulted in massive over-regulation for the European asset management industry which has to dedicate enormous resources to compliance with this regulation.

Other jurisdictions, such as the United States, also take investor protection and systemic resilience into account. However, they have complemented these legitimate political objectives with a third one: Fostering the global competitiveness of the domestic financial industry. In doing so, they give the relevant industries more financial leeway to cut costs and to invest more money in forward looking aspects of business such as artificial intelligence, big data and other technological developments, which in turn strengthens their competitiveness at the global level. We believe it is essential that the EU also enshrines this third objective in its regulatory framework.

Recommendations

- The future European Commission President's mission letter to the college shall promote the competitiveness of European companies as well as reciprocity with other jurisdictions as a further political goal in addition to consumer protection and financial stability.

- The "scope of action" of the ESAs, as laid down in the founding Regulations (EU) 1093, 1094 and 1095/2010 shall be amended by adding as the need to strengthen the global competitiveness of the relevant industry as an additional objective. Assets under management, employment numbers and revenue could serve as criteria to determine the competitiveness of the European sector.

- To enhance awareness at an institutional level we suggest the creation of a specific unit in DG FISMA and/or the Secretariat General of the Commission dedicated to ensuring the competitiveness of European financial services sector is actively fostered. In addition the criteria for the impact assessment of proposals by the Regulatory Scrutiny Board should be amended to ensure that this element of competitiveness is fully taken into account.

- The EU voice in international standard-setting organisations, such as FSB and IOSCO, should be strengthened; key European interests should be pursued more vigorously.

- Allow the ESAs to issue time-limited 'no action letters' to avoid situations of practical impossibility for financial actors to apply new regulation (e.g. variation margins or Cat. 3 clearing obligations under EMIR).

Priority No 2: Delivering on "better regulation"

The EU should finally deliver on its promise regarding better regulation. IN this context, we have the following ***Recommendations:***

- Ten years after the financial crisis, there should be a pause in regulatory initiatives to allow existing regulation to be closely scrutinised in respect of its overall effectiveness and consistency.

- Streamline existing reporting obligations to remove inconsistent, duplicative or overly complex requirements and to build on the conclusions of the public consultation on the fitness check of supervisory reporting (UCTIS, AIFMD, EMIR, SFTR, MIFID/MIFIR reporting requirements).

- Financial regulation should become again more principle-based in order to allow for more proportionality and adaptation to different business models.

- EU legislators must make elementary decisions themselves during the Level 1 procedure, rather than dumping them on Level 2 and Level 3 discussions.

- The entry into force of legislation, especially of Level 2 measures, shall provide for sufficient implementation time.

- Consultations, impact assessments and evaluations in the REFIT program should not only take scientific cost/benefit analyses of future legislation into account, but also include practical experience from market participants. This could also foster fair access to, and price for, data provided by market data providers (data and benchmarks providers, platforms).

Priority No 3: Commensurately unleashing the potential of sustainable finance

The transition to a more sustainable environment is one of the key challenges for Europe. A growing number of institutional investors and asset managers already select investments taking into account material ESG considerations throughout their portfolios. The dynamic of this development must not be impeded through overburdening, duplicative and inconsistent requirements. Market participants have to be able to move forward from their different starting points to prevent discouragement of engaging in sustainable finance. To ensure that sustainable finance reaches its full potential and to allow the entire European financial industry to contribute to more sustainable development, we recommend the following:

- Sustainable finance regulation shall distinguish between the mandatory management of financial risks and the voluntary financing of sustainable goals. Legal requirements shall neither interfere with investors' free decision nor determine the use of their capital.

- Sustainable finance regulation shall promote a positive and forward-looking approach towards sustainability. Overly strict requirements will impede the perception of sustainability as an element of corporate strategy and lead to "tick the box" compliance exercises.

- Sustainable finance regulation shall allow for a viable transition of the real economy, taking into account the different business sectors and their respective challenges.

- Sustainable finance regulation shall be part of a comprehensive sustainability strategy, ideally based on common measurable objectives agreed at international level, voluntary mobilisation of capital as well as mandatory consideration of material risks to the return of investment.