



**EUROPEAN COMMISSION**

Directorate-General for Financial Stability, Financial Services and Capital Markets Union

**FINANCIAL MARKETS**

**Capital Markets Union**

## **CONSULTATION DOCUMENT**

### **CAPITAL MARKETS UNION MID-TERM REVIEW 2017**

#### **Disclaimer**

This document is a working document of the Commission services for consultation and does not prejudge the final decision that the Commission may take.

The views reflected on this consultation paper provide an indication on the approach the Commission services may take but do not constitute a final policy position or a formal proposal by the European Commission.

You are invited to provide feedback on the questions raised in this consultation document **between 20 January and 17 March 2017** at the latest to the **online questionnaire** available on the following webpage:

[https://ec.europa.eu/info/finance-consultations-2017-cmu-mid-term-review\\_en](https://ec.europa.eu/info/finance-consultations-2017-cmu-mid-term-review_en)

Please note that in order to ensure a fair and transparent consultation process **only responses received through the online questionnaire will be taken into account and included in the report summarising the responses.**

Respondents are invited to provide evidence-based feedback and specific operational suggestions.

This consultation follows the normal rules of the European Commission for public consultations. Responses will be published unless respondents indicate otherwise in the online questionnaire.

Responses authorised for publication will be published on the following webpage:

[https://ec.europa.eu/info/finance-consultations-2017-cmu-mid-term-review\\_en#contributions](https://ec.europa.eu/info/finance-consultations-2017-cmu-mid-term-review_en#contributions)

## CONTENT OF THE CONSULTATION DOCUMENT

### **Purpose of this consultation:**

*The Commission aims to publish the Mid-term Review of the Capital Markets Union (CMU) Action Plan<sup>1</sup> in June 2017. The Mid-term Review aims to:*

- *take stock of progress on the implementation of the CMU Action Plan;*
- *reframe actions in the light of work undertaken so far and evolving market circumstances;*
- *complement the CMU Action Plan with new measures which constitute an effective and proportionate response to key challenges.*

*This consultation provides an opportunity for stakeholders to provide targeted input to revise the CMU Action Plan. The preparation of the CMU Mid-term Review will also draw on relevant submission and findings from the Commission's Call for Evidence on the EU regulatory framework for financial services<sup>2</sup>.*

### **INTRODUCTION**

The Capital Markets Union (CMU) is a core component of the Commission's Investment Plan for Europe to boost jobs, including youth employment, and growth. It encompasses the reforms of our financial system needed to enable the flow of private capital to fund the EU's pressing investment challenges – in the domains of infrastructure, energy transition, and particularly in financing growing businesses. CMU seeks to better connect savings to investment and to strengthen the EU financial system by enhancing private risk-sharing, providing alternative sources of financing, and increasing options for retail and institutional investors. Removing obstacles to the free flow of capital across borders will strengthen the Economic and Monetary Union by supporting economic convergence and helping to cushion economic shocks in the euro area and beyond, making the EU economy more resilient. This is even more important in the current economic environment.

The CMU Action Plan of September 2015 set out a comprehensive programme of 33 actions to put in place the building blocks for the CMU. Alongside the Single Market Strategy<sup>3</sup> and Digital Single Market Strategy<sup>4</sup>, CMU sits at the heart of the EU reform agenda for a deeper and fairer Single Market, and remains a flagship priority of this Commission.

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<sup>1</sup> [Action Plan on Building a Capital Markets Union, COM\(2015\)468 final, 30.9.2015](#)

<sup>2</sup> [Call for Evidence – EU Regulatory framework for financial services, COM\(2016\) 855 final](#)

<sup>3</sup> [Communication of 1 June 2016 on "Delivering the Single Market Agenda for Jobs, Growth and Investment", COM\(2016\)361](#)

<sup>4</sup> [Communication of 6 May 2015 on "A Digital Single Market Strategy for Europe", COM\(2015\) 192 final](#)

The evolving economic and political context in the EU, as well as pronounced differences in the maturity of capital markets across Member States, shows that developing stronger capital markets in the EU is more important than ever. The EU economy needs bigger and better capital markets to help break its reliance on bank lending and diversify its sources of funding. The configuration of EU capital markets is faced with significant change in the years ahead. However, whatever the precise configuration of those markets, it is clear that the EU must remain strongly focussed on developing capital market finance as a complement to a restored banking system, and to ensure that, as capital markets deepen, the capacity to supervise and manage risks keeps pace. The work on setting the broad policy framework and creating the right enabling conditions for capital markets to finance the real economy should continue.

This is why on 14 September 2016 the Commission adopted a Communication<sup>5</sup> to reaffirm its commitment to the CMU. This Communication calls for an acceleration of the reforms and reviews priorities. The Commission firmly believes that, to reap the benefits of the first CMU commitments, there is a need to speed up the legislative process, starting with the long overdue securitisation package and the implementing measures of the Prospectus Regulation.

The CMU pipeline is delivering. Some 15 initiatives have been completed by the Commission, which corresponds to almost one-half of the CMU Action Plan. Several more will be completed in the coming months. As we approach the end of the delivery of the first wave of CMU-building, it is appropriate to take stock of what has been done, its effectiveness in addressing policy challenges, and how to build on these foundations.

The aim of this consultation document is to seek feedback on how the current programme can be updated and completed so that it represents a strong policy framework for the development of capital markets, building on the initiatives that the Commission has presented so far. To support the discussion, this document provides an up-to-date overview of the state of implementation of the CMU Action Plan.

The document retains the structure of the CMU Action Plan which identifies six policy areas on which CMU building should focus. Under each heading, the consultation paper identifies outstanding issues and challenges, having briefly recalled the drivers for policy action and the work done so far.

Respondents are invited to provide concise and operational suggestions on measures that can be enhanced and on complementary actions to deliver the policy goals.

## **1. FINANCING FOR INNOVATION, START-UPS AND NON-LISTED COMPANIES**

### ***Policy drivers:***

New start-up companies are critical to driving growth in the economy. Entrepreneurs with promising business plans need to secure financing to realise their ideas. Successful firms need access to financing on attractive terms to fund their expansion. However, funding channels for growing firms seeking to raise equity capital or credit outside the banking system are underdeveloped in the EU. This is particularly the case for the EU's SMEs. A successful CMU should broaden the range of financing options for growing

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<sup>5</sup> [Communication of 14 September 2016 on "Capital Markets Union-Accelerating Reform", COM\(2016\)601 final](#)

companies. These opportunities should exist and be available to entrepreneurs across all EU Member States and across all stages of the 'funding escalator'.

***State of play of implementation:***

<b>Action</b>	<b>Results achieved</b>	<b>Next steps</b>
Proposal for a pan-European venture capital fund-of-funds and multi-country funds	November 2016: call for expressions of interest in managing the Pan-European Venture Capital Fund-of-Funds programme, backed by €400m EU budget, leading to higher levels of investment in innovative companies.	Call for applications open until end January 2017. Commission and EIF will select managers, who should at least match the EU budget contribution (i.e. at least €800m in total).
Revise EuVECA and EuSEF legislation	July 2016: Commission's proposal to revise the regulations to boost investment into VC and social projects and make it easier for investors to invest in innovative SMEs. Council general approach agreed on 5 December 2016.	Agreement by the co-legislators
Study on tax incentives for venture capital and business angels	January 2016: launch of a study on the effectiveness of such incentives. October 2016: workshop with Member State experts.	March 2017: second workshop with Member States experts planned.
Strengthen feedback given by banks declining SME credit applications	On the request of the Commission Services, EU banking associations are developing high-level principles on the feedback to be given by banks to SMEs with declined credit applications.	Formalisation of the high-level principles on banks' feedback.
Map out existing local or national support and advisory capacities across the EU to promote best practices	September 2016: workshop on the advisory support for SME access to finance. Under preparation: investigation on how to develop or support pan-European information systems for SMEs.	A collaborative platform is being established to facilitate exchange of best practice.
Report on crowdfunding	May 2016: Commission Services report on the EU crowdfunding sector.	Ongoing project on market and regulatory barriers to cross-border crowdfunding activity; and dialogue with Member States and industry.
Work with Member States and European Supervisory Authorities (ESAs) to assess the need for a coordinated approach to loan origination by funds and the case for a future EU framework.	Ongoing	Under consideration

Promote private placements	December 2016: launch of a study to identify the regulatory and market barriers to the development of private placements. Ongoing Commission Services' support to market-led initiatives <sup>6</sup> .	Draw on best practices and promote them across the EU.
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**Key trends and challenges:**

The CMU and the Banking Union reinforce each other. Market-based finance is needed to **complement** bank lending. While there is a need to strengthen the EU banking system to ensure that it is sound, the banking system also needs to be complemented with alternative sources of funding. Bank credit is more difficult to obtain for young companies without collateral or fixed assets and with uncertain future profitability. Financing constraints remain, and one of the biggest challenges of CMU is to strengthen non-bank sources of finance for innovative companies and EU businesses with high-growth potential. This means providing funding solutions tailored to the investment needs of companies from start-up through scale-up and expansion.

The EU financial landscape is already changing in ways that increase the availability of risk capital for high growth small and medium-sized companies. CMU is therefore realising an overdue structural shift in the EU's financial system, and seeks to channel this dynamic effectively. CMU aims not only at broadening the sources of finance for SMEs, but also at extending their geographical reach to all Member States, so that they can tap those new financial circuits that are of greatest benefits to them. However, more needs to be done to enhance these dynamics and ensure that EU companies can access alternative sources of funding to grow their business. Recent reports underline the lack of "unicorns" (private companies valued at over €1 billion) in the EU. The EU has only 17 unicorns in just a handful of Member States (as of July 2016), which compares to 90 in the US and 40 in Asia.

**Crowdfunding** is growing but remains small. The total EU online alternative finance market, which includes crowdfunding, peer-to-peer lending and other activities, grew by 92% to reach €5.4 billion in 2015.<sup>7</sup> Market development is concentrated in a few Member States, and cross-border activity is low. Across the EU, perceptions toward existing national regulations in alternative finance are divided. Divergences in regulatory frameworks and in interpretation of EU rules applying to crowdfunding may lead to market fragmentation and challenge investor protection.

The EU experienced a drop in both **venture capital (VC)** funding and the number of venture deals during 2016.<sup>8</sup> EU venture capital funds remain fragmented and lack scale

<sup>6</sup> For example, the launch of the European Corporate Debt Private Placement (ECPP) Guide by the International Capital Markets Association in October 2016.

<sup>7</sup> University of Cambridge Centre for Alternative Finance (2016), *Sustaining Momentum – The 2<sup>nd</sup> European Alternative Finance Industry Report*.

<sup>8</sup> KPMG and CB Insights, *Venture Pulse Q4 2016 – Global Analysis of Venture Funding*. Available at: <https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2017/01/venture-pulse-q4-2016-report.pdf>.

(the average size of EU VC funds is half the average size of US funds) and geographical reach (around 90% of VC investment is concentrated in eight Member States<sup>9</sup> and VC investment is virtually non-existent in some Member States). The EU VC market needs to stimulate private VC funding as government agencies have been the most important contributor to the €40 billion that the EU VC market has raised since 2007<sup>10</sup>. Good progress has been made on the venture capital package of the CMU Action Plan, but other options could also be explored. For example, venture debt (which is typically raised by companies that also have venture capital investors) is well developed in the US but is in its infancy in the EU (20% of US companies raise venture debt at some point, compared to 16% for Canadian and 7% for European companies).<sup>11</sup>

SMEs have difficulties in navigating new funding opportunities. This reflects, to a large extent, **information barriers** between SMEs and prospective investors/lenders. There is a wealth of useful experience across Member States in delivering relevant information to firms which could benefit from alternative funding sources, and the Commission has already identified some good practice. Also, solutions enabled by technology and data analytics create opportunities in this field. It will be important to build pathways between the most successful national or regional support platforms and to pursue the opportunities offered by digital technologies to ensure that all SMEs across the EU can benefit from this information.

**Private placements** of debt (such as the German *Schuldschein* or the Euro-PP markets) play an increasingly important role in the funding of mid-sized firms (€ 32 billion were raised in the EU through this channel in 2015, versus € 40 billion in the US) but are concentrated in just a handful of Member States (notably France and Germany). While Euro-PP private placements issues were sluggish during the first six months of 2016 (only reaching € 2.5 billion of volume down by 49% compared to the first half of 2015), the German *Schuldschein* market will likely hit record levels in 2016, with a volume of € 11 billion issued in the first half of 2016.<sup>12</sup>

**Pre-IPO** (initial public offering) non-bank finance remains largely absent, in particular in small Member States, notably in Central and Eastern Europe (CEE). The sources of pre-IPO investment are typically private equity funds raising capital from banks, institutional investors (insurance companies, pension funds, investment funds) or high net worth individuals. The dynamics of pre-IPO funding sources need to be strengthened. For example, in CEE Member States private equity deals would grow by 591% per year if all countries were as developed as the "best in class" in the asset class.<sup>13</sup>

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<sup>9</sup> United Kingdom, Germany, France, Sweden, the Netherlands, Spain, Austria and Finland.

<sup>10</sup> Invest Europe

<sup>11</sup> Duruflé, Hellman and Wilson (2016), 'From Start-up to Scale-up: Examining Public Policies for the Financing of High-Growth Ventures'.

<sup>12</sup> Private Placement League Table - Standard & Poor's (2016); *Schuldschein* Market well on tracks to new records- Scope Ratings AG (2016); US (Reg D) Private Placement Market, Dealogic (2016).

<sup>13</sup> AFME and New Financial, *The Benefits of Capital Markets to High Potential EU Economies*, November 2016. Available at: <http://newfinancial.eu/wp-content/uploads/2016/11/2016.11-The-benefits-of-capital-markets-to-high-potential-EU-economies-final.pdf>.

## Question:

*Are there additional actions that can contribute to fostering the financing for innovation, start-ups and non-listed companies? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.*

## 2. MAKING IT EASIER FOR COMPANIES TO ENTER AND RAISE CAPITAL ON PUBLIC MARKETS

### *Policy drivers:*

Public offers of debt or equity instruments are the principal funding route for mid-sized and large companies seeking to raise in excess of € 50 million. They offer access to the widest set of funding providers and provide an exit opportunity for private equity and business angels. Public markets are vital for the transition of high growth mid-sized companies to established global players.

### *State of play of implementation:*

Action	Results achieved	Next steps
Proposal to modernise the Prospectus Directive	November 2015: the Commission adopted a proposal for a Prospectus Regulation. December 2016: Agreement by the co-legislators.	Put in place implementing measures, notably on the alleviated disclosure schedules for SMEs.
Review regulatory barriers to SME admission on public markets and SME Growth Markets	October and December 2016: two workshops on fostering admission of SME shares to trading; solutions to regulatory issues and market failures; and barriers to SME Growth Markets.	Commission Services will produce a report in 2017.
Review EU corporate bond markets, focusing on market liquidity	July 2016: launch of study on the drivers of liquidity in corporate bond markets. October 2016: launch of an expert group to find practical solutions for improving the functioning of these markets.	Study will be published in the summer of 2017; the expert group will produce a report presenting its analysis and recommendations by September 2017.
Address the debt-equity bias, as part of the legislative proposal on Common Consolidated Corporate Tax Base	October 2016: Commission proposed the introduction of a corporate tax offset (2% + baseline) allowance for equity issuance as part of the proposal for a Common Consolidated Corporate Tax Base (CCCTB).	Agreement by the Council.

### *Key trends and challenges:*

The size of EU public equity and debt markets **still lags behind other developed economies**. The level of development also varies significantly across Member States. Accessing public markets is costly and complex. The cost of listing for companies (IPOs)



is high and often outweighs the benefits of going public. **IPO activity** in the EU remains subdued. The year-to-date IPO proceeds in Q3 2016 amounted to €18.2 billion, which is 49% lower in comparison with the same period in 2015 (€35.7 billion).<sup>14</sup> This weak IPO activity means that there are still limited equity raisings by EU companies, especially the smallest ones.

The potential of public markets is particularly underutilised for **small and mid-cap companies**, as there are several barriers to SME listing. The cost of going public is relatively high for smaller issues and SMEs. The erosion of the local ecosystem (e.g. analysts, brokers, auditors specialised in SMEs) that traditionally bring SMEs to public markets also constrain the supply of companies seeking a listing. The lack of investment research on SMEs has a negative impact on the liquidity of their shares and their cost of capital. There is a need to facilitate access to public markets. Companies that have crossed over from private and bank funding to public listings outstrip their privately-owned counterparts in terms of annual growth and workforce increase.

To support SME listing, MIFID II will create a new Multilateral Trading Facility (MTF) category of SME Growth Markets. Other EU texts or proposals<sup>15</sup> also refer to this new category of trading venue and provide incentives for SMEs to list their shares on those exchanges. The Call for Evidence identified that the market abuse regime places a high burden on issuers listed on SME Growth Markets, which may ultimately result in less activity and thus reduced financing for SMEs. Particular concerns relate to the widening of scope of issuers' duties under MAR to companies listed on MTFs, such as providing insider lists and notifying managers' transactions<sup>16</sup>. As part of the broader work on SME listing, the Commission will assess the implementation of the rules under MiFID II on investment research in relation to SMEs. While the changes are expected to reduce conflicts of interest, the effect of the rules on the provision of SME research needs to be monitored closely.

**Corporate bond markets** have witnessed significant structural and policy changes that have had an impact on their efficiency and resilience. As many factors, possibly including regulation, appear to affect market liquidity, respondents to the Call for Evidence agreed on the need to gather more data and deepen the understanding of recent liquidity dynamics<sup>17</sup>. The Commission Services are undertaking a review of the functioning of EU corporate bond markets. The review is focusing on how market liquidity can be improved, the potential impact of regulatory reforms and market developments.

Member States in CEE face the biggest challenges in terms of development of their public markets. From 2012 to 2015, corporate bonds accounted for 24% of the EU corporate debt in the EU as a whole while they stood at 15% in the CEE Member States. Likewise, the value of IPOs in the CEE Member States (relative to GDP) has dropped by three quarters over the past decade (2006-2015).

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<sup>14</sup> Source: PwC IPO Watch Europe Q3 2016

<sup>15</sup> Market Abuse Regulation (Regulation No 596/2014); Central Securities Depositories Regulation (Regulation No 909/2014) and the Prospectus Regulation proposal and the EuVECA Regulation Proposal.

<sup>16</sup> [Call for Evidence – EU Regulatory framework for financial services, COM\(2016\) 855 final, p 6](#)

<sup>17</sup> [Call for Evidence – EU Regulatory framework for financial services, COM\(2016\) 855 final, p 5](#)

Tax distortions favour **debt issuance over equity**. This distorts financing decisions, makes companies more vulnerable to bankruptcy and undermines the stability of the overall economy. A deeper integration of public equity markets also supports more resilient cross-border risk sharing.

**Question:**

*Are there additional actions that can contribute to making it easier for companies to enter and raise capital on public markets? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.*

**3. INVESTING FOR LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT**

**Policy drivers:**

The EU requires significant new long term and sustainable investment to maintain and extend its competitiveness and shift to a low-carbon and resource-efficient economy. Institutional investors, in particular life insurance companies and pension funds, are natural long term investors. Institutional and other private investors can be an important source of funding for infrastructure investments as these investments can offer stable returns and a relatively strong credit performance history. Reforms for sustainable finance are necessary to support investment in clean technologies and their deployment, ensure that the financial system can finance sustainable growth over the long term, and contribute to the creation of a low-carbon, climate-resilient circular economy. Efficient capital markets play a key role in financing sustainable investments in the EU and abroad as they can help investors to make well-informed decisions, monitor and analyse relevant risks, price long-term risks and consider opportunities, including those arising from the move towards a sustainable and climate-friendly economy.

**State of play of implementation:**

Action	Results achieved	Next steps
Adjust Solvency II calibrations for insurers' investment in infrastructure and European Long Term Investment Funds	The Commission amended the Solvency II Delegated Act to reduce the risk charges for qualifying equity and debt investments in infrastructure projects and ELTIFs. The new rules entered into force in April 2016.	Review calibration of risk charges for infrastructure corporates.
Review of the CRR for banks, making changes on infrastructure calibrations, if appropriate	The Commission proposed to lower credit risk capital requirements for banks' exposures to infrastructure as part of the CRR/CRD review in November 2016.	Agreement by the co-legislators on the CRR/CRD review.
Call for evidence on the cumulative impact of the financial reform	The Commission adopted the Communication "Call for Evidence - EU regulatory framework for financial services" in November 2016.	Follow-up to the Communication

Support sustainable investment	In October 2016 the Commission adopted a Decision on the creation of a High-Level Expert Group on Sustainable Finance (HLEG)	HLEG is expected to issue an interim report in June 2017 and propose operational policy recommendations on the path towards an effective EU sustainable finance agenda by the end of 2017.
Assessment of the prudential treatment of private equity and privately placed debt in Solvency II	Private equity and privately placed debt cover a broad range of products, while Solvency II calibrations are based on objective asset classes or on qualifying criteria. Commission Services are analysing how insurers invest in private equity and privately placed debt, and how these investments are offered to them.	If changes to the Solvency II framework are warranted, they would be brought forward in the context of the Solvency II review.
Consultation on the main barriers to the cross-border distribution of investment funds	The consultation closed in October 2016. In parallel, the expert group on national barriers to the free movement of capital discussed barriers to cross-border marketing of funds under AIFMD and the transparency of regulatory fees.	The Commission Services are currently assessing the results of the consultation and will identify appropriate follow-up action, potentially including legislative and non-legislative actions.

***Key trends and challenges:***

The EU continues to face daunting challenges in terms of funding infrastructure development, low-carbon transition, demographic ageing and the corporate sector. Investment in the EU has not recovered from the crisis. Gross fixed capital formation which averaged 24% of GDP prior to the crisis has struggled to exceed 20% in recent years; a shortfall which is explained largely by a reduction in private – as opposed to public sector – investment. This is not just a drag on current growth and employment, but means that the EU is not provisioning for future needs. Funding these investment shortfalls requires mobilising reserves of institutional capital and enabling their allocation to these asset classes.

**Long-term investment** requires institutional investors with long-term liabilities, such as insurance undertakings and pension funds. Moreover, private capital from institutional investors and banks needs to be crowded into the financing of the EU's infrastructure. Less than 1% of total assets from the insurance industry are allocated to investing in equity shares and loans for infrastructure projects. Although insurance companies have been rebalancing some of their direct investment in equity shares (currently at 6%) to indirect investment in equity shares via investment funds<sup>18</sup>, the overall investment by insurance companies in equity shares remains small. Respondents to the Call for Evidence suggested that regulation may reduce financial institutions' ability to finance long-term investments, in particular infrastructure investments.<sup>19</sup>

Moreover, while the **ELTIF framework** has been tailored to mobilise capital for infrastructure and small firms, this market is in its infancy and its development needs to be facilitated.

<sup>18</sup> European Insurance — Key Facts

<sup>19</sup> [Call for Evidence - EU regulatory framework for financial services, COM\(2016\) 855 final, p 5](#)

Despite significant progress achieved over the past decades, the Single Market for **investment funds** (UCITS and AIFMD) remains fragmented. Investment funds in the EU remain smaller and less cost efficient than in the US and the distribution of funds remains geographically limited. This is driven to a large extent by home-host regulatory issues, as recalled by respondents to the Call for Evidence.<sup>20</sup>

There is a growing focus on green, or more broadly, **sustainable finance**. Investors, and in particular institutional investors, have started revisiting their investment strategies in carbon-intensive assets and for sectors exposed to potentially stranded assets (notably for fossil fuel firms and energy companies). However, common definitions and standards (what is green and how to measure it?) are lacking. Capital markets remain under-utilised to redistribute capital from polluting industries into environmental technologies, and investors do not sufficiently integrate wider sustainability factors into investment decisions, as evidenced by the recent public consultation on long-term and sustainable investment. At the same time, the increasing development of sustainable finance flow can make a sizeable contribution to the achievement of EU as well as internationally agreed climate and environmental goals (e.g. Paris Agreement).

**Question:**

*Are there additional actions that can contribute to fostering long-term, infrastructure and sustainable investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.*

#### **4. FOSTERING RETAIL INVESTMENT AND INNOVATION**

**Policy drivers:**

Retail savings held directly or indirectly through asset managers, life insurance companies and pension funds are key to unlocking capital markets. The under-development of capital markets hampers the EU's ability to provide rewarding investment opportunities for savers and retirement provision. Part of the solution is providing effective access to capital markets for EU retail investors, offering sound and rewarding investments on attractive terms and appropriate investor protection. The CMU aims to put EU retail savings to better use, by improving the efficiency through which savers and borrowers are matched, and by increasing the economic performance of the EU economy.

**Personal pensions** have a key role to play. They help households to save for retirement and get familiar with capital markets. Personal pensions link long-term savers with long-term investment opportunities. They help address the demographic challenges of aging populations by securing adequate replacement rates in the future as a complement to state-based or occupational pensions and help to adjust to evolving working patterns among the workforce.

The Single Market for **retail financial services** is not performing to its full potential, with only very limited cross-border purchases being made by consumers (only 7% of the

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<sup>20</sup> [Call for Evidence – EU Regulatory framework for financial services, SWD\(2016\) 359 final p. 52](#)

over 24,000 respondents have purchased financial products or services in another Member State).<sup>21</sup>

***State of play of implementation:***

Action	Results achieved	Next steps
Green Paper on retail financial services and insurance <sup>22</sup>	The Commission adopted a Green Paper on Retail Financial Services.	Action Plan on Retail Financial Services expected in Q1 2017.
EU retail investment product markets assessment	Commission Services launched a study on the distribution systems of retail investment products across the EU and asked the ESAs to work on the transparency of fees and net performance of long-term retail and pension products.	Results of the study expected by the end of 2017.
Assessment of the case for a policy framework to establish European personal pensions	Commission Services conducted a public consultation and launched a study on tax aspects of personal pensions.	Legislative proposal expected in Q2 2017.

***Key trends and challenges:***

Retail investors **lack confidence** in capital markets. A large part of EU savings are held in bank accounts at relatively short maturities. This situation could be sub-optimal for certain savers, depending on their financial situation and risk profile. Encouraging and enabling Europeans to save more effectively to meet future financial needs is more crucial than ever in the context of low interest rates and the risk of an insufficient retirement income due to demographic developments. Greater retail investor engagement is also critical for mobilising equity financing for SMEs and long-term funding of the economy.

Retail investor confidence should be strengthened, but it will be difficult to catalyse the necessary improvements without transparency around costs and fees, given their impact on the net performance of financial products. In particular, the new product disclosure rules under MiFID II, PRIIPS and IDD need to be put to work and effectively support retail investors in their investment choices. Supervisory authorities can help to build retail investor confidence into capital markets by ensuring those recent reforms are appropriately implemented across the EU. A number of consumer representatives responding to the Call for Evidence argued about the misalignment of the various regulations addressing the transparency of distribution costs (e.g. inducement payments, commissions). As a result, similar retail financial products and services may be less or more transparent

<sup>21</sup> Special Eurobarometer 446, July 2016, available at: <http://ec.europa.eu/COMMFrontOffice/PublicOpinion/index.cfm/Survey/getSurveyDetail/instruments/SPICIAL/surveyKy/2108> (Eurobarometer 446), pages 12 and 15; More evidence on the fragmentation of the European Single Market for retail financial services is provided in the Green paper on retail financial services, available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2015:630:FIN>

<sup>22</sup> [Green Paper on "Retail Financial Services - Better products, more choice, and greater opportunities for consumers and businesses", COM\(2015\) 630, 10.12.2015](#)

depending on the type of distribution channel. Such differences could also be responsible for the lack of competition in some markets<sup>23</sup>.

Currently, many smaller investors are **paying too much for modestly or sometimes poorly performing retail investments** in comparison with a simple bank savings account.

A patchwork of rules at EU and national levels stands in the way of the full development of a large and competitive market for **personal pensions**. The public consultation on a potential EU framework for personal pensions, which was organised in 2016, confirmed strong support from both savers and the industry for a legislative proposal to underpin the development of personal pensions across the EU. Respondents to the Call for Evidence also argued that certain efficiencies in cost, management and administration could be achieved by pooling assets on a cross-border basis, benefitting EU savers and the EU capital markets.

**FinTech** benefits retail investors by offering a wider choice of services which are more convenient to use or more easily accessible. There is a need to ensure that the regulatory framework strikes an appropriate balance between enabling the development of FinTech on a pan-EU basis and ensuring confidence for investors. But innovation could assist those retail investors that already have the confidence and knowledge to have access to more diverse product offerings. It could also enable investors with limited knowledge and experience to become familiar with capital markets and related opportunities and risks. Respondents to the Call for Evidence stressed that level-playing field arguments must be looked at in a holistic way. The nature of the entity and the risk of its business, including its size and interconnectedness, may also determine the set of applicable rules. A choice has to be made between a 'same risk, same regulation/different risk, different regulation' approach and a 'same activity – same regulation' approach<sup>24</sup>. In order to help FinTech innovation reach its full potential, while ensuring financial stability and consumer confidence, the Commission Services set up in November 2016 an internal Financial Technology Task Force. That Task Force brings together Services responsible for financial regulation and for the Digital Single Market, along with Services dealing with competition, research and innovation, and consumer protection policy. The Task Force was created with the aim of formulating policy-oriented recommendations and proposing measures in the course of 2017.

***Question:***

*Are there additional actions that can contribute to fostering retail investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.*

**5. STRENGTHENING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY**

***Policy drivers:***

As lenders to a significant proportion of the economy and intermediaries in capital markets, banks play an important role in the CMU and in the wider EU economy. SMEs

<sup>23</sup> [Call for Evidence – EU Regulatory framework for financial services, COM\(2016\) 855 final, p 13](#)

<sup>24</sup> [Call for Evidence – EU Regulatory framework for financial services, COM\(2016\) 855 final, p 13](#)

in particular rely primarily on the banking sector for financing, representing up to 75% of external finance. For smaller companies, strong local networks are important in supporting growth. Credit unions, for example, in which SMEs can finance each other on a not-for-profit basis, operate in some Member States. Securitisation can increase the availability of bank credit, reduce the cost of funding, contribute to a well-diversified funding base and act as an important risk-transfer tool to improve capital efficiency and allocate risk to match demand. Covered bond markets are also an important channel for longer term financing, being instrumental for credit institutions to efficiently channel finance to the real estate market and for publicly guaranteed instruments including some SME loans.

***State of play of implementation:***

Action	Results achieved	Next steps
Explore the possibility for all Member States to authorise credit unions outside the EU's capital requirements rules for banks	Commission proposed an amendment to the CRD which empowers the Commission to exempt the entire credit union sector of a Member State from the CRD, upon conditions.	Agreement by the co-legislators.
Proposal on simple, transparent and standardised (STS) securitisations and revision of the capital calibrations for banks	Commission proposal adopted in 2015	Agreement by the co-legislators.
Consultation on an EU-wide framework for covered bonds and similar structures for SME loans	Consultation concluded and an ongoing study is looking at specific aspects of covered bonds.	Under consideration
Benchmarking of national loan enforcement frameworks (including insolvency) from a bank creditor perspective	Commission Services launched a study on outcomes that banks experience under the different national systems in terms of delays, costs and recovery value when managing defaulting loans.	Results of study expected in Q4 2017.

***Key trends and challenges:***

In recent years, the need for EU banks to de-risk and de-leverage has contributed to a sharp contraction of the flow of new loans to the non-financial corporate sector (40% compared to 2008). Access to credit has been more difficult in countries where banking systems are undergoing adjustment. In a well-diversified financial system, the banking sector must remain a key source of finance for the corporate sector, including SMEs. Efficient capital markets solutions can help banks to manage their balance sheets better and strengthen banking capacity through risk transfer, wholesale funding and the pricing of illiquid assets.

The EU's **securitisation markets** remain however significantly impaired, damaged by concerns surrounding the securitisation process and the risks involved. Soundly structured, securitisation is an important channel for diversifying funding sources and enabling a broader distribution of risk by allowing banks to transfer the risk of some exposures to other banks or long-term investors such as insurance companies and asset managers. A rapid implementation of the STS securitisation package will pave the way for a revival of the market.

**Covered bond** markets remain fragmented along national lines and concentrated in a few Member States. Based on the results of the recent public consultation and ongoing study, the Commission will set out as part of the CMU mid-term review which legislative changes may be needed to support the development of covered bond markets throughout the EU.

CMU is also an opportunity for the provision of alternative solutions to the handling of **non-performing loans (NPLs)**. The latest Annual Growth Survey underlines that the high level of non-performing loans remains a serious challenge in a number of Member States. Non-performing loans and operational inefficiencies, in combination with a low-interest and a low-growth environment, impact banks' profitability. This in turn impacts banks' ability to raise new capital in support of new lending and therefore on their ability to support the economic recovery. There are differences in the efficiency of national insolvency systems and their impact on banks' ability to recover value from NPLs. To address the issue of the high level of NPLs using capital markets, it could be envisaged to create a secondary market for NPLs in ways that facilitate the transfer of NPLs without compromising the contractual protections for the debtor.

*Question:*

*Are there additional actions that can contribute to strengthening banking capacity to support the wider economy? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.*

## 6. FACILITATING CROSS-BORDER INVESTMENT

*Policy drivers:*

Despite significant progress in recent decades to develop a single market for capital, there are still many long-standing and deep-rooted obstacles that stand in the way of cross-border investments, which deter investors from diversifying their portfolios geographically. These obstacles have their origins in national law – insolvency, collateral and securities law, as well as market infrastructure and tax barriers. For example, **discriminatory tax treatment** of pension funds and insurance companies (e.g., higher taxation of dividends paid to foreign pension funds as compared to taxation of dividends paid to domestic pension funds) may deter these institutional investors from engaging in cross-border operations.

Cross-border trades are on average still more expensive than domestic trades (e.g., some fund management firms may incur up to ten times higher costs on identical services). An efficient **post-trading environment** can reduce such costs. There is a need to increase legal certainty on the applicable national law to security ownership in cross-border securities trades. Differences in the national treatment of third-party effects of assignment of debt claims complicate the use of these instruments as cross-border collateral and make it difficult for investors to price the risk of debt investments.

More effective **supervision** is essential to ensure orderly markets and investor protection, and to promote the integration of capital markets by ensuring that the single rulebook is



consistently applied across the EU. As capital markets become more integrated and national barriers are gradually removed, the supervisory framework should be strengthened to ensure the solidity of all financial actors. **Financial stability** risks emerging from more integrated capital markets need to be monitored and mitigated.

There is also a need to **broaden the geographical reach of capital markets so that all Member States reap the benefits of deeper and more integrated capital markets**. Challenges are particularly pressing in CEE Member States. CMU can be a means to accelerate the development of those parts of the capital market architecture that require proximity and local solutions for SME funding, coupled with access to deeper capital markets elsewhere in the EU.

*State of play of implementation:*

Action	Results achieved	Next steps
Report on national barriers to the free movement of capital	Commission Services set up a Member States' expert group to identify barriers and best practices in removing them, and to set out a roadmap of actions that Member States would be encouraged to take by 2019.	Adoption of the report expected in Q1 2017.
Targeted action on securities ownership rules and third-party effects of assignment of claims	Uncertainty over which law applies in the event of legal challenges on ownership in chain transactions involving different Member States gives rise to costs and risk.	Legislative proposal underway.
Review progress in removing remaining Giovannini barriers	Establishment of the European Post-Trade Forum (EPTF) to assess the extent to which the Giovannini barriers have been removed and identify any new or emerging barriers.	Finalisation of EPTF Report and launch of a public consultation is expected in Q2 2017. Communication on post-trade expected in Q4 2017.
Legislative initiative on business insolvency	Commission proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures.	Agreement by the co-legislators.
Best practice and code of conduct for relief-at-source from withholding taxes procedures	The Commission Services are working with Member States to agree on a Code of Conduct.	Code of Conduct expected by the end of 2017.
Study on discriminatory tax obstacles to cross-border investment by pension funds and life insurers	Study was commissioned in December 2016.	Results expected in September 2017.
Strategy on supervisory convergence to improve the functioning of the single market	ESMA implemented its first annual work programme on supervisory convergence and is preparing a second such programme. Work is ongoing to assess how to strengthen the effectiveness and efficiency of supervision at macro and micro-prudential level.	Continue to support ESMA's work on convergence.

Develop a strategy for providing technical assistance to Member States to support capital markets' capacity	Commission proposal on the establishment of a Structural Reform Support Programme.	Agreement by the co-legislators expected in H1 2017, followed by the launch of CMU-related projects
Review of the EU macro-prudential framework	The Commission Services conducted a public consultation	Follow-up measures in 2017.

### ***Key trends and challenges:***

Cross-border risk sharing within the EU has weakened since the start of the crisis and investment coming from outside the EU has also declined over the same period.

Despite significant progress achieved over the past decades, a number of barriers to the **free movement of capital** remain. These barriers deter institutional investors such as investment funds and pension funds, and retail investors to make full use of the Single Market potential. Some pension funds invest cross-border, but seem to do so to a large extent outside the EU.

There is evidence that tax barriers continue to hinder cross-border investment. **Withholding tax procedures** are considered as a major barrier to cross-border investment. Double taxation agreements concluded between states should normally allow investors directly or indirectly investing (among others) through investment funds to avoid double taxation, either by getting relief at source or by benefiting from full or partial refund. Total cost of withholding tax refund processes is estimated at € 8.4 billion per year.

Divergences in **corporate governance** frameworks may deter investors from investing in equity across borders and from exercising efficient oversight over companies' management and board. In particular, there is evidence from the recent consultation on long-term and sustainable investment<sup>25</sup> and from recent calls for EU action on corporate governance<sup>26</sup> about the need for better corporate board accountability for long-term value creation. Enhanced board accountability could further improve the interaction between shareholders and the company, and contribute to better corporate governance, and would therefore complement the recently agreed Shareholders Rights Directive<sup>27</sup>.

Divergences in **supervisory outcomes** lead to cross-border spill-overs and unjustified differences in the supervision of the same risk. Deeper financial integration will need to be accompanied by increased focus by ESMA on achieving convergence of supervisory outcomes across the EU and necessary adjustments to strengthen the supervisory framework in order to ensure that the capacity to supervise and manage risks keeps pace, in particular in cross-border and critical areas. ESMA has stepped up its efforts to foster supervisory convergence and has made more active use of the instruments at its disposal.

<sup>25</sup> [http://ec.europa.eu/justice/newsroom/civil/opinion/151211\\_en.htm](http://ec.europa.eu/justice/newsroom/civil/opinion/151211_en.htm)

<sup>26</sup> Corporate Governance policy in the European Union-Through an Investor's Lens, CFA Institute, 2016

<sup>27</sup> [Proposal for a Directive of the European Parliament and of the Council on amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, 15248/16, 13.12.2016](#)

Sustained efforts, building on these promising steps, are needed to improve the functioning of the single market.

***Question:***

*Are there additional actions that can contribute to facilitating cross-border investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.*

**NEXT STEPS**

The Commission Services will carefully evaluate the responses to this consultation and produce a summary feedback statement. In parallel to the consultation, the Commission Services are holding more focused roundtable discussions on three topics: SME access to finance, retail investor engagement and institutional investment. The consultation process will be concluded by a Public Hearing in Brussels on 11 April 2017.

As announced in the Commission's 2017 Work Programme, the intention is to complete the CMU Mid-term Review in June 2017 with a view to taking stock of progress on the implementation of the CMU Action Plan and identifying potential additional measures required to improve the financing of the economy.