AmCham EU
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

Our position

Capital Markets Union 2.0: priority actions for functioning eco-systems

AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €3 trillion in 2020, directly supports more than 4.8 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

Executive Summary

The European Commission's first Capital Markets Union (CMU) action plan in 2015 sought to develop a deep, frictionless Single Market for financial services. Five years on, in its second CMU action plan, the European Commission outlines a comprehensive strategy to further unlock the potential of capital markets across Europe.

This renewed effort is particularly needed to address the continued fragmented state of Europe's capital markets, which Brexit risks exacerbating and which represents an obstacle to cross-border investments and the efficient allocation of capital. Thriving and globally connected capital markets will play a critical role in the economic recovery from the current crisis.

As such, AmCham EU believes that ongoing and future CMU initiatives should strive to avoid fragmentation of liquidity, help diversify sources of funding and improve the flow of investment information. Importantly, the Action Plan recognises that EU capital markets are stronger and more attractive when they are open to global financial markets. Whilst we understand the political drivers underpinning the Commission's objective for EU markets to achieve 'open strategic autonomy', we are concerned about the inherent tension embedded in that objective – and urge policy makers to ensure that concrete initiatives taken do not undermine the commitment to openness.

Capital Markets Union Action Plan objectives

AmCham EU supports the CMU Action Plan's objectives of improving financing options for European companies, given that equity risk capital is particularly important for innovative companies; making the EU a safe place to invest for the long term; and greater integration of capital markets by removing national barriers.

Among the 16 actions proposed by the Commission, AmCham EU has identified five top priority actions to improve European capital markets, which should be tackled in the short term. These include:

1. Review of Central Securities Depositories Regulation (CSDR);
2. European single access point (ESAP);
3. Listing rules for public markets;
4. Securitisation;
5. Withholding tax procedures.

As a second step, it has also identified five further 'tier two' priorities, to be addressed in the mid- to long-term. These include a review of the legislative framework for European long-term investment funds; the EU financial competence framework; comparability of retail investment information; pension adequacy; and harmonisation of non-bank insolvency laws.

AmCham EU advocates for increased regulatory coherence underpinned by cross-border regulatory and supervisory co-operation. We believe that openness to wholesale capital flows and market participants will be a key driver to grow and sustain efficient, effective and competitive capital markets in Europe that can support recovery post COVID 19.

Introduction

Capital markets are eco-systems. Developing capital markets requires different and complementary measures that support a variety of activities and participants in the eco-system. Accordingly, we believe that the CMU Action Plan should be treated as a package, and that it is important to make progress on all the actions contained in the Action Plan. Yet, certain actions can be achieved more quickly than others.

Globally coherent regulation underpinned by regulatory and supervisory co-operation – the foundation for a successful CMU

Fragmenting capital markets through regulatory action increases risks, complexity and costs for all users of financial services, particularly retail consumers. AmCham EU advocates for increased regulatory coherence underpinned by cross-border regulatory and supervisory co-operation. While acknowledging the legitimate need for some local adaptation, we believe that, for wholesale capital markets which are fundamentally global, alignment to or definition of global standards increases the attractiveness of European capital markets and reduces the possibility of conflicts of law hampering growth.

Recommendation
We encourage the establishment of formal consultative mechanisms between regulators and supervisors to support inter-jurisdictional deference. In the context of Brexit, this will be particularly important between the EU and the UK, and between the EU and the United States.

In addition to international coherence and alignment, increased consistency throughout the EU would benefit European capital markets. That is, consistency in Member State implementation of EU regulations and approaches to supervision, as well as market practices.

Recommendation
We strongly support the work of ESMA on supervisory convergence, which should encourage, rather than restrict internationally recognised practises, such as delegation of portfolio management to third countries.

Coherent and consistent regulation coupled with cross-border regulatory and supervisory co-operation provide the foundation for openness. Wholesale capital markets are global. A default position of openness to wholesale capital flows and market participants will be a key driver to grow and sustain efficient, effective and competitive capital markets in Europe that can support recovery post COVID 19.

Priorities for the CMU

We believe that the actions in the Action Plan should be prioritised in two main categories. A first category identifies five initiatives that need to be prioritised to remove fundamental obstacles to the efficient functioning of capital markets that will either enable, or remove barriers to both intra-EU capital movements and to foreign investment in the EU. These are Action 13 (the CSDR rules on settlement discipline that need modifying before their starting date of February 2022, as well as Actions 1 (setting up ESAP), 2 (increasing SME access to public markets), 6 (restarting securitisation) and 10 (revising the current cross-border withholding tax system).

The second category is that of actions that will need a longer period of time, as they require either a full rethink of current regulatory frameworks or tackling barriers embedded in national laws and practices. These actions, although complex and challenging, have enormous transformational potential. They include Action 3 (making the European Long-Term Investment Funds [ELTIF] framework a true EU label, similar to UCITs), Actions 9 (pension adequacy), and 11 (harmonisation on non-bank insolvency laws).

We are encouraged that the 2 December 2020 Council CMU conclusions[1] take a similar approach, recognising that actions 1 (ESAP), 2 (SME funding/public listings), 3 (ELTIF review) and 6 (securitisation) should also be given priority. We believe that action 13 (CSDR) should also be on the priority list.

Top five priority actions

1. Review of Central Securities Depositories Regulation (action 13)

The review of the Central Securities Depositories Regulation (CSDR), and especially the review of the CSDR settlement disciple regime (SDR), is an urgent and critical pre-condition for the development of capital markets in Europe.

In their current form, the CSDR settlement discipline rules, especially the CSDR mandatory buy-in rules, which are due to apply from February 2022, will reduce the efficiency of European capital markets, leading to greater costs, wider bid-offer spreads, and less liquidity. They will act as a barrier for foreign investors in European securities and will encourage the transfer of capital markets activity outside of Europe. They will have a particular negative impact smaller corporate clients and SMEs, whose securities have lower inherent liquidity. AmCham EU welcomes the European Commission’s recent targeted public consultation on CSDR, and stresses that market participants will need to be advised as early as possible of planned changes to the rules.

Recommendation
A **change of a buy-in from a mandatory obligation into a voluntary, optional right** is the single-most important change that is needed to the rules.

2. European single access point (action 1)

AmCham EU is convinced that **increasing transparency, availability and timeliness of information, in particular financial statement information, will provide the greatest benefit to creating deeper EU capital markets**. A standardised repository with complete and timely information on company financials has the potential to greatly enhance investor participation in financing European companies, especially SMEs. Financial statement information is the most important piece of information in evaluating the credit riskiness of a private company. A large hurdle for investor participation in SME capitalisation is the availability of complete and timely information. While the lack of corporate data is less of an issue for listed companies, the vast majority of European SMEs are unlisted. At present, no Europe-wide private company database is available. There is, similarly, no accepted definition of what constitutes a micro-cap, small or medium-sized company due to the huge differences in the corporate set-ups in various European countries. Creating an ESAP could alleviate the fragmentation faced by international investors.

As is recognised in the Action Plan, it will be important to **avoid duplicating companies’ reporting burden**. For this purpose, we recommend a phased implementation of the ESAP which should first focus on the development of the European Single Electronic Format (ESEF) to ensure coherent approach across EU legislation and to leverage existing framework. As stated in the first paragraph, it is essential for there to be a clear use case and purpose for the ESAP and avoid confusion. We support and agree with the Commission’s stated ambition that the ESAP should not aim to require the disclosure of additional information nor to modify the content of existing disclosure requirements but address the way in which they are collected and disseminated. Hence, we propose the EU should focus on collecting existing company level financial and non-financial information. It would be impractical and unviable to include value add services such as analytics from the Non-Financial Reporting Directive or benchmark Environmental Social Governance (ESG) disclosures as proposed in the consultation.

[1] https://data.consilium.europa.eu/doc/document/ST-12898-2020-REV-1/en/pdf

After an initial set-up stage, we believe the scope of the ESAP could be expanded, to include further corporate disclosures, such as “material loan agreements”. Furthermore, the ESAP could help with the harmonisation of EU shareholder disclosure requirements. For example, national rules on notifications of major shareholdings under the Transparency Directive vary significantly across the EU. In particular, there are differing thresholds, differing deadlines for disclosure, differing methods of calculating levels of investment and no centralised reporting channel for notifying issuers.

Recommendations
A standardised repository with complete and timely information on company financials has the potential to greatly enhance investor participation in financing European companies, especially SMEs.
Creating an ESAP could **alleviate the fragmentation** faced by international investors.
A phased implementation of the ESAP should first **focus on the development of the European Single Electronic Format (ESEF)** to ensure coherent approach across EU legislation and to leverage existing framework.
Focus on collecting **existing company level financial and non-financial information**. Avoid inclusion of services such as analytics from the Non-Financial Reporting Directive or benchmark Environmental Social Governance (ESG) disclosures as proposed in the consultation.

3. Listing rules for public markets (action 2)

A vibrant and deep public equity market is a cornerstone of thriving capital markets. AmCham EU acknowledges that the Prospectus Regulation is not the major determinant in a decision by a company to launch an initial public offering (IPO), but it can influence the decision on the location of the IPO and the regulatory process can impact the risk of execution ie whether an IPO succeeds or fails. Reducing the risk of execution could reduce the number of IPOs withdrawn or postponed.

On the matter of choice of location for the IPO, the biggest issue is the free float requirement – companies do not necessarily want to sell 25% at IPO. AmCham EU recommends a move to a secondary market liquidity assessment to replace minimum percent free float requirements. On reducing the risk of execution, AmCham EU recommends allowing for greater flexibility in the IPO process and the priorities for reform are: greater flexibility on the price range and deal size, including the removal of 48-hour withdrawal rights where the price or size change is not significantly altering the fundamentals (balance sheet) of the company post-IPO; and shortening the IPO timetable.

Recommendations
Replace minimum percent free float requirements with secondary market liquidity assessment.
Allow for **greater flexibility** in the IPO process.

4. Securitisation (action 6)

AmCham EU supports Action item 6 to review the EU’s securitisation framework. When developed in such a way as to be responsible, prudentially sound and transparent, we believe **securitisation is an important vehicle to increase the capacity of banks to lend and also for investors to have access to European credit products, acting as a bridge between the Banking Union and the Capital Markets Union**. While progress was made in the last Commission through the Securitisation Regulation, including the creation of ‘Simple, Transparent, and Standardised' (STS) criteria, we believe the following improvements can be made to boost securitisation:

Recommendations
Increased certainty and transparency: establish a clearer role for competent authorities in significant risk transfer assessments, improved credit underwriting standards and non-performing loan (NPL) reduction, and the inclusion of credit information on EU companies in a European Single Access Point (ESAP).
Prudential: amend the EU prudential rulebook and the Basel framework when it comes to recalibrating capital charges for senior securitisation tranches (both for banking and insurance) and when reassessing criteria under the Liquidity Coverage Ratio (LCR). It is important that the review at Basel occurs to address level playing field concerns from misaligned rules in different jurisdictions, which reduces the ability for international banks to support local securitisation issuance.
Synthetic securitisation: there can be an improved role for synthetic securitisation, and the Commission should look at its scope in an STS context and in terms of regulatory treatment of Synthetic and Cash securitisation.
Disclosure: There is currently a lack of proportionality for private transactions which are required to provide disclosure in line with that of a public transaction. The requirements should be more proportionate to the nature of private transactions.
Third-country securitisation: There is currently a lack of clarity around disclosure and due diligence requirements in the STS. U.S. securitisation does not meet some of the transparency requirements because U.S. law does not apply the same standards. This in turn makes U.S. (and other third country) securitisation ineligible for UCITS investment which is a negative outcome for undertakings for the collective investment in transferable securities (UCITS) investors who lose opportunities for diversification and volatility management. We therefore echo the recommendation in the High-Level Forum report, which calls for a review of disclosure and due diligence requirements under the Securitisation Regulation in relation to third country securitisation, as well as public and private securitisation.

5. Withholding tax procedures (action 10)

From a practical perspective, complex, inefficient, paper-based withholding tax procedures are the biggest single barrier to cross-border investment in the EU. The COVID-19 crisis has demonstrated the vulnerability of current processes, and the benefits of streamlined and digital processes, from the perspective both of investors and of tax authorities. The objectives of Action 10, namely, a common, standardised, EU-wide system for withholding tax relief at source, and to allow investors to provide one set, and not 27 sets of tax forms, are indispensable to build a true Capital Markets Union, and to attract investment into European capital markets.

Recommendations
Create a common, standardised **EU-wide system for withholding tax relief** at source.

Tier two priority actions

1. Review of the legislative framework for European long-term investment funds (action 3)

Europe needs a true EU label that accommodates the growing needs and demands of long-term retail investors in Europe and beyond, a fund vehicle that would help drain the demand for long-term investments in real assets – and complement the highly successful EU UCITS label for traditional funds managing securities portfolios. ELTIF could become the natural home for all forms of patient investments, be it infrastructure, real estate or private equity. However, its take-up has been very limited.

With appropriate recalibrations to both attract retail investors and increase their investment fire-power**, ELTIFs would be able to concretely help turn savers into investors (a crucial piece of the CMU project), generate an additional source of retirement income and support the transition towards the Paris Agreement climate change targets.**

2. EU financial competence framework (action 7)

AmCham EU fully recognises the need to **develop an EU financial competence framework, considering in particular the democratisation of finance through digitalisation**. This could usefully support several other CMU actions, in particular those seeking to increase retail investor participation and help fill another important gap between the US and the EU.

3. Comparability of retail investment information (action 8)

Somewhat related to the above, **AmCham EU also supports initiatives such as action 8 which help remove national barriers to cross-border investment and improve the flow of information**. It is also coherent with the push for the EU single access point.

4. Pension adequacy (action 9)

AmCham EU believes that the topic of pension adequacy is of fundamental importance for capital markets, as savings for pensions are the largest single source of funds that are available for investment in capital market instruments. EU Member States have a relative shortage of long term risk capital as represented by funded pension assets. The three largest pools of funded pension assets are the Netherlands $1.5 trillion, Germany $680 billion and Sweden $470 billion compared to: US $15.5 trillion, UK $2.8 trillion, Japan $1.4 trillion, Canada $1.5 trillion and Australia $1.8 trillion. Enhancing the flow of pension savings into European capital markets will be transformational.

AmCham EU believes that Action 9 on pension adequacy is a useful starting point for such a transformation, and urges the Commission to take forward this action. However, AmCham EU also believes that by itself Action 9 will not be sufficient to achieve the transformational effects, and that further steps will need to be taken.

5. Harmonisation of non-bank insolvency laws (action 11)

The lack of investor legal certainty due to the fragmentation of non-bank national insolvency regimes has been a long-standing obstacle to greater cross-border investment in EU small and large corporates. **AmCham EU fully supports the Commission's continued attempts at 'chipping at' the issue despite the significant political challenges.**

Conclusion

The Capital Markets Union Action Plan is a package, and it is important to make progress on all the actions contained in the Action Plan. Yet, as this paper has identified, certain actions should receive greater political focus than others.

AmCham EU calls for action on five priority initiatives in order to focus action on removing fundamental obstacles to the efficient functioning of capital markets that also act as a barrier for foreign investment in the EU, ie Actions 13 (CSDR rules on settlement discipline), 1 (ESAP), 2 (SME access to public markets), 6 (securitisation) and 10 (withholding tax).

As a second step, European policy-makers should look to address actions which have longer-term transformational potential. These actions include Actions 3 (European Long-Term Investment Funds [ELTIF]), 9 (pension adequacy), and 11 (insolvency).