SFC response to CMU Green Paper consultation

Priorities for early action

1) Beyond the five priority areas identified for short term action (Prospectus Directive review; facilitating information sharing about SMEs; securitisation; long-term investment, and private placement markets), what other areas should be prioritised?

To begin with some overarching general points, the SFC strongly believes it will be vital for the success of the CMU that there is **a timetable with well-defined responsibilities** for delivering it. The CMU action plan should set out ambitious yet achievable goals alongside timely intermediate steps. Time, moreover, is of the essence. **The time-frame for implementation should be more ambitious**, five rather than ten years. This will require focussing rigorously on the main issues which can actually be implemented, building, initially, in areas where infrastructure is in place and capital markets are working well, so as to give the project greater economic traction. Measures should be simple, non-regulatory where possible, and there should be **an emphasis on both the investor and the issuer/originator side of the equation**.

In addition to the five priority areas identified for short term action, a sixth priority area should be introduced, namely a Capital Markets Union without borders. We strongly believe that greater focus on incentivizing and actively attracting international capital sources to invest in the EU can greatly enhance the chances of success of the Capital Markets Union.

There is an urgent need for the EU to foster co-operation with partner countries, international companies, institutional and individual investors, to enable the EU to take a leading role in getting global capital markets flowing again while ensuring maximum capital flows to Europe. By 2013 global capital flows had dropped to a third of what they were in 2007 according to data from the BIS, and this was more pronounced in Europe than other parts of the world. As one of the world's leading trading areas, deeply interconnected with the global economy, it is crucial to the success of the CMU project to reverse this trend in the retrenchment of capital flows. A CMU without borders is also a priority in recognition of the fact that a redeployment of investment capital away from bank deposits and into capital market securities, will mean changing entrenched behaviours, which will take some time. Whilst this rebalancing is taking place during on-going bank deleveraging, the ability for 3rd country risk capital to access the EU will be central to CMU's success. Taking action in this area would also greatly contribute to reversing the unfortunate and costly trend toward fragmentation of capital markets and participants.

We give more detail in our response to question 21, but specifically, the CMU action plan should include:

- Institutionalised regulatory dialogue and policy-making that always takes account of the international angle, especially the relationship to the EU's most important partner countries;
- a systematic review of existing regulation to remove barriers for investment and pro-actively avoiding taking positions on pending regulations which could hamper the CMU targets (e.g. Trading Book review, Credit Risk Modelling)

- the EU taking the lead in advocating international not regional standards (i.e. beyond the EU), while ensuring that among EU Member States a coherent approach is taken to implementing EU legislation without gold-plating, and
- Actions to further improve the third country equivalence determination process.

In the case of equivalence, timely and predictable determination of the regulatory and supervisory arrangements in place in third countries is essential to achieve the legal certainty that capital market participants need. An immediate action to enable third country firms to contribute to the success of the CMU is to determine equivalence in files such as EMIR, AIFMD, MiFID2/R and BRRD in line with a consistent, outcome-based approach. This should be accompanied by consultations with the third country competent authorities prior and throughout the equivalence assessment process in order to enhance understanding of the third country regulatory regime. This approach would also provide relief to the scarce resources involved in the ESAs and the Commission and, thus lead to a shortened timeframe for the assessment. Finally, alignment of EU legislation to internationally agreed standards and principles (e.g. BCBS, IOSCO, FATF) would help facilitate and expedite the equivalence determination process. In this respect the Commission should seek close regulatory dialogue and cooperation with foreign regulators to ensure that international standards and principles are transposed in a consistent way across jurisdictions.

We believe these are quick and easy wins for the Commission, because with the exception of actions stemming from the review of existing regulation, **they require no new legislation, and can easily be achieved through internal reorganisation and improved coordination** delivering a significant non-regulatory step forward, in-keeping with the new Commission's better regulation objectives.

- <u>Institutionalised regulatory dialogue and policy-making that always takes account of the international angle</u>

  - Always taking account of the external dimension in policy and regulatory development. In particular, the impact on capital flows between the EU and its partner countries should be thoroughly considered in Commission Impact Assessments. Measures that undermine cross-border investment and access to firms with expertise in market intermediation that can help make the CMU a success should be avoided, and measures to promote them should be adopted instead.

  - The Commission should proactively work with partner countries when implementing the CMU action plan. The aim is to avoid, for example, the negative consequences of EMIR and Dodd-Frank, where ineffective co-operation in the early stages of policy development contributed to the US and EU taking different paths to achieve the same policy objectives, and led to an incoherent approach to derivatives regulation. More generally, EU authorities should institutionalise regulatory dialogue with partner countries by proactively engaging with them, at both policy and regulatory levels, so as to avoid incompatible approaches that may further undermine capital flows. The Commission should prioritise engagement with those partner countries most willing and able to contribute to the EU's economic recovery.

- <u>A systematic review of existing regulation to remove barriers to investment</u>

Measures to review existing and forthcoming regulation to remove unnecessary obstacles and/or deterrents to capital flows, both on a standalone and cumulative basis, in particular through addressing divergent national implementation in Member States and gold-plating in the implementation phase. We present a detailed list of such barriers in our response to question 21, but our concerns relate in particular to the **disproportionately broad retail client classification in MiFID II, the potential liquidity and trading market distortive effects of the MiFID II trade transparency regime, the proposed FTT, which will also undermine liquidity, and the impact on the supply and demand for liquid collateral** caused by prudential and securities rules.

We are particularly concerned to ensure a proper calibration of the trade transparency requirements for bonds and derivatives to prevent or limit the detrimental impact on market liquidity crucial to the attractiveness of the EU fixed income capital market. Also making fixed income trading fully transparent on a single day, 3rd January 2017, risks re-pricing the entire market overnight and creating market disruption. It is highly unlikely that industry or regulators can achieve the necessary systems build out in time without a phase-in.

The cumulative impact of regulatory reforms on collateral is of significant concern because it could give rise to a collateral squeeze and thus inadvertently trigger a systemic crisis. **An adequate supply of serviceable collateral plays a central role in market-based credit intermediation, is central to the functioning of the global financial system, and is critical to the success of the CMU.** Limits to capital re-use, such as those under the ESAs proposed rules for non-cleared OTC derivatives margining, can undermine securities markets and lead to funding stresses that reverberate across financial markets. Measures in CMU should clarify appropriate levels of permissible re-hypothecation, transparent collateral ownership, and lead to the removal of barriers to cross-border collateral use.

Another important example of existing legislation that limits the potential contribution of investors to CMU is the very broad scope of the Retail Client category in MiFID I and MiFID II, which ranges from basic bank account customers (who need the highest level of protection) to very experienced and sophisticated clients with assets suitable for investment in capital markets, and who have corresponding risk appetites. MiFID client classification rules inappropriately prevent such experienced investors from being treated as professional clients, constraining the choice of instruments they may invest in, the way they can be serviced by investment firms, and their ability to geographically diversify due to restrictive rules on using third-country firms. In the same vein, the new MiFID II third country regime will treat retail clients and those retail clients who have opted for the Professional Client status similarly, should a Member State require third-country firms to establish a branch to provide investment services. **All these restrictions prevent such experienced investors from contributing to the success of the CMU, and thus clearly go against the CMU objectives of improving access to financing, increasing cross-border investment, and fostering connections with global capital markets.**

- <u>The EU taking the lead in advocating international not regional standards (i.e. beyond the EU), while ensuring that among EU Member States a coherent approach is taken to implementing EU legislation without gold-plating</u>

  - The EU should take the lead in promoting international standards, by working with partner countries through multilateral institutions.
  - Moreover, the ESAs should encourage greater supervisory convergence and consistent implementation, and discourage gold-plating. Some of the consumer information requirements are overly complex, and thus despite plenty of information being available, do not leave consumers better informed. The ESAs could collate and distribute advice and best practice to national authorities on how to better protect consumers without introducing requirements having adverse effects.

- <u>Actions to further improve the third country equivalence determination process</u>

  - Timely and predictable equivalence determination of the regulatory and supervisory arrangements in place in third countries is essential to achieve the legal certainty that capital market participants need to trade and offer trading services.
  - As an immediate action, the most effective approach to provide access to third country firms in a shorter time frame than the CMU is to further improve the equivalence assessment process already enshrined in the context of a number of existing directives and regulations, by pursuing a consistent, outcome-based approach (aimed at evaluating whether the third country regime achieves the same regulatory objectives as the corresponding piece of EU legislation). This applies for instance to files such as EMIR, AIFMD, or MiFID2/R or BRRD, where consultations with the third country prior and throughout the equivalence assessment process would contribute significantly to an efficient equivalence assessment due to specialist national (third country) knowledge. This approach would also provide relief to the scarce resources of the involved ESAs and the Commission and, thus, might lead to a shortened timeframe for the equivalence decision and assessment.
  - Further alignment of EU legislation to internationally agreed standards and principles (e.g. BCBS, IOSCO, FATF) would help facilitate and expedite the equivalence determination process. In this respect the Commission should seek close regulatory dialogue and cooperation with foreign regulators to ensure that international standards and principles are transposed in a consistent way across jurisdictions. Recent EU legislation on margin requirements for un-cleared OTC derivatives and on benchmarks clearly illustrate the challenge of regulatory alignment as regulators tend to add their "own finish" to standards/principles agreed at international level.

2) What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?

The SFC considers that more information about SME credit ratings, credit scoring, could be useful, but only for those larger mid-cap firms who are more likely to access credit markets. For the rest of the sector, additional reporting requirements could quickly become an additional burden, and even for mid-caps, this should be optional.

The SFC also believes that there is a high risk that the proposed MiFID II Level 2 framework for payment for investment research will greatly reduce the availability of information to equity and fixed income investors. These provisions would have particular impact for research on SMEs, further reducing the availability of information on SMEs and consequently reduce the willingness of capital market investors to provide funding to SMEs. Non-bank investors currently lack information on SMEs which materially undermines their willingness to invest and investment research can play a crucial role in providing information and analysis to investors regarding SMEs to enable potential investors to better appraise investment risk which will increase their willingness to invest as investors cannot be expected to invest in products they don't understand. It is therefore essential that a proportionate approach is taken under MiFID II that appropriately balances investor protection with the availability of research across all types of firm.

3) What support can be given to ELTIFs to encourage their take up?

Measures facilitating international investment into ELTIFs, in particular through standardisation of format and regulation and acceptance of ELTIFs as permitted investment for institutional investors by each national regulator would help expand the stock of available capital for investment, and encouraging take-up in their adoption. Various national restrictions for cross-border provision of services on banking law, insolvency and tax regimes should be addressed. Examples of the existing obstacles to cross-border cooperation of ELTIFs include the inability of funds to originate loans (need for a banking licence), restrictions on the availability of credit data, and different tax treatments (withholding tax on interest). The European Commission should encourage Member States not to introduce unfavourable tax treatment for investments in ELTIFs.

Additionally, the ease with which to invest in European infrastructure as an asset class (and investment in such assets through an ELTIF structure) needs to be improved (see our answer to question 10).

4) Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?

There is a lack of standardisation across private placement markets which constitutes a barrier to entry for new issuers and investors into the private placement market. To address this, the industry is already working on private placement best practice via the Pan-European Private Placement Joint Committee, coordinated by ICMA. This work should form the basis of a market led solution, addressing issues such as uncertainty about the capital treatment of European private placement bonds, restrictions in Member States for institutional investors like pension funds investing in pooled fund solutions holding illiquid assets, and distribution rules. While avoiding over-regulation we would welcome a light-touch approach from the Commission to support this work , promoting a consistent approach of these best practice rules within Member States and beyond. If necessary, some harmonisation to enable cross-border funding should be considered.

<u>Improving Access to Finance</u>

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

The SFC suggests looking at small, mid and large cap companies and the questions around their access to finance, holistically. The EU should aspire to a globally competitive capital markets for companies of all sizes, as well as a seamless “funding escalator” for small companies that wish to grow to mid-cap, and mid-cap companies wishing to grow to large cap, without impediments or difficulties accessing capital for their next level of development. A holistic review may yield a clearer picture than piecemeal efforts targeting each of small and mid-sized companies. This will ensure that highly competitive European start-ups have the possibility to scale up rapidly and achieve pan European or even global stature, before being overtaken by technologies and competitors in other jurisdictions. In this context we would like to mention the role of the Business Development Companies in the US that are used as lending platforms in the small/mid-cap space, they have no corporate level tax and are favoured by investors. A similar vehicle could be considered for replication at the EU level.

Some specific aspects of this could include:

- Opening up capital markets to the issuance and trading of more medium-sized company debt. A distinct and separate SME market regime is foreseen in MiFID2, which could ensure that EU regulation does not adversely impact small companies. This can also help the trading of less liquid SMEs shares.
- Review the treatment of securitisation instruments in existing and forthcoming regulations, such as the Liquidity Coverage Ratio, capital requirements, Solvency II, and the FRTB, to increase attractiveness of the asset class via less punitive risk weights and broader LCR buffer eligibility.

Properly regulated simple, standardised and transparent securities can incentivise investment and help finance growth, yet their current treatment in prudential regulation is disproportionately punitive.

- The EU could consider measures that would increase the availability of and access to information on borrowing and investing for SMEs. Such information sharing and enabling measures could be an important aspect of the Capital Markets Union.

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

We believe that greater secondary market transparency goals must be appropriately balanced with the interests of corporate issuers. We appreciate the attractiveness of the theoretical argument that liquidity could be improved by the standardization of corporate bond issuance. However the market reality suggests the case may be far less convincing. This is likely to be particularly counterproductive for SMEs which have very bespoke financing needs, and significant flexibility is required to facilitate tailored solutions.

Some argue that issuers should bring a smaller number of more sizeable standardised benchmark bonds to the market at regular intervals, rather than issuing a large number of sometimes sub-benchmark sized issues scattered across the curve with non-standard coupon dates and features, with benefits from aggregating secondary market liquidity. There would be significant implications for issuers, which should be weighed equally. Issuers currently have the ability to opportunistically come to market to take advantage of optimal funding conditions, whether that be through the use of non-standard features, a below benchmark size issue, or their ability to issue a private placement. If issuers were to agree to only issue benchmark-sized bonds with standard features and at regular intervals, this would seem to limit corporates in ways at odds with their duty of care to shareholders. Unless such standardised issuer behaviour was imposed by law, the CFO of a company would be unable to justify more costly, higher risk and suboptimal funding decisions to its shareholders, just because it was encouraged to issue on a set date in a particular quarter when there happened to be a market dislocation.

Therefore, while we appreciate the potential positive implications for secondary market liquidity that standardised corporate bond issuance might suggest, we question the feasibility of such a move. Outside of introducing new laws, it would be hard to envisage a scenario under which issuers would willingly give up such flexibility, and in our view, it would likely raise more questions than it would answer.

While standardisation of corporate bond issuance in itself is neither desirable nor required, we do believe that standardisation of some definitions and market practices is desirable. The bond markets in Europe are growing at a very strong rate, in part due to the need by issuers to diversify their funding sources away from bank lending and also, as investors seek the ability to diversify their investment portfolios. The bond markets have a history of innovation and providing solutions for issuers and investors alike. Some examples over the last 40 years include exchangeable securities, corporate hybrids and contingent capital securities. Also full standardisation is undesirable from an issuer viewpoint as one shape does not fit all – the challenges and requirements facing one issuer may be different to those faced by a similar borrower. Investors will be disadvantaged as they will be offered less product if the resultant standardisation creates a class of instrument that doesn't suit all issuers. One example is the proposal for the harmonising of coupon and maturity dates, as this is likely to lead to spikes and dips in liquidity which would add stress to the financial system not reduce it.

What investors should be provided with is a clear and transparent understanding of the notes that they are buying so they are best able to compare and contrast. A standardized term sheet that is available to any investor, private or institutional, for every transaction would likely add liquidity and transparency to the markets.

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

Public actors' combination of ESG and financing capacity has often been a crucial trigger for private investors to come on-board. Given the novelty, scale and policy risk involved in growing some ESG investment solutions, public sector support will be needed to lift investment ratings to levels that are attractive to investors. Such support would then leverage the availability of private capital for such solutions. Typical measures include guarantees for underlying liabilities, credit enhancement, subsidies, and tax incentives.

We would highlight that this area is not only about standards alone but also about quality control. More transparency by the financial institutions on the impact of their products should be encouraged, be it through impact measures or 'labels' that make the contents and impacts comparable (e.g. the transparency label for funds of European Sustainability Investment Forum, the Novethic SRI label and Responsible Investment Association Australasia certification program). Alternatively, an appropriate quality assurance system could be developed.

Regulators should also promote and incentivise the knowledge of impact and sustainability. Advisors should know how to assess sustainability-related risks and opportunities – this could be built into professional curricula – to grow the trained workforce organically. Although training incurs cost, having more competent staff on a broader range of impacts of products and services (including environmental and social impacts) can reduce operating costs, increase revenues as well as allow businesses to become more sustainable.

Furthermore, we also encourage the Commission to look at the effects that other regulatory actions have on sustainable and impact investing.

As a final point, we would like to highlight is that the current activity by many governments to support the sector, create labels, structures, finance whitepapers and even seed funding, also creates a huge regulatory burden for asset and investment managers with regards to how they must run their business and how they are supposed to market investment products. This is having a negative effect particularly on small, nascent and innovative players, thus inadvertently hampering innovation.

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

A common and simplified EU reporting standard could be helpful to SMEs listed on MTFs who wish to raise market capital. However, given the potential regulatory burdens, this would need to be an optional measure. Any standard should draw on the work already developed by the IFRS, which already reduces the administrative burden of full IFRS.

In addition, the SFC suggests that the Commission considers a review of existing and upcoming reporting requirements to streamline and make them consistent, so as to make compliance for originators easier and more reliable, as well as assisting investors and other users of the data.

9) Are there barriers to the development of appropriately regulated crowd funding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

No response.

Developing and diversifying the supply of funding

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

The regulatory framework could do more to facilitate long-term investors as a source of financing. Areas were policy could be examined relate in particular to tax incentives; furthermore, it is important to allow firms, both EU and non-EU, unencumbered or harmonised access to institutional investors across the Member States. At the moment there is a significant fragmentation due to domestic regulation and legislation effectively creating barriers to entry.

Measures to pursue include:

- The SFC believes that measures that can reduce the political and regulatory uncertainty around infrastructure projects will help encourage institutional investment. For SMEs, the issue is around equity funding, and measures that can facilitate it should be prioritised.
- Solvency II could more easily promote long-term investment if the prudential requirements for insurers investing in infrastructure and high-quality securities were reviewed in particular with regard to a more beneficial capital treatment.
- Review the zero % risk weight for EU sovereign debt in CRD IV as this incentivises investors to buy public debt and crowds out investors in corporate debt and results in investment decisions not based on the risk/reward characteristics of the investment.
- When devising and implementing regulation, avoid geographical bias, e.g. in the design of funding vehicles, and inconsistent implementation of EU standards which can deter investment from other EU Member States and partner countries. For example, implementation of the Alternative Investment Fund Managers Directive (AIFMD) – though the passport has been very helpful for EU funds managed by EU managers - has in some cases closed borders to smaller-non domestic funds as some Member States have strengthened their private placement regime.
- One way to increase liquidity in the market for SME financing could be to have different accounting regimes for the asset class for banks, insurers, and AIFMs. If some are under different regimes than others, a more liquid market would ensue as the risk can be transferred from one enterprise regime to another. We believe that homogenized accounting and capital regimes increase market illiquidity and dislocation as the market can have an imbalance of buyers and sellers.
- Review the treatment of securitisation instruments in existing regulations, such as the Liquidity Coverage Ratio, capital requirements and Solvency II, to ensure equivalence with other asset classes. Properly regulated simple, standardised and transparent securitisation instruments can incentivise investment and help finance growth, yet their current treatment in prudential regulation is disproportionately punitive.
- Help develop simple, transparent securitisation products, for example through a standardised legal framework for securitising SME loans, and thus facilitating a pan-European market (both cash and synthetic). Consideration should be given to the cost and size requirements for SMEs to issue debt/equity which are often too high for small firms.

- Implement tax incentives in favour of long term investments and harmonise the withholding tax regime in Member States.

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

Optimizing the pan-EU passport for institutional investors/funds which is currently provided for under AIFMD, but not fully functional, should be a high priority. In this respect it is important to ensure that the administrative fees charged by Host State authorities for the processing of marketing notifications and further additional procedural requirements are not excessive and do not render the use of the AIFMD passport economically unattractive. Moreover, Member States' passport processing procedures should be more transparent and harmonised. The EU has long offered in the form of UCITS a successful pan-EU retail fund vehicle, but this is not yet the case for institutional investors. Such a vehicle should be fully accessible to investors from outside the EU.

Legal costs:

- Legal costs incurred due to navigating all the different member state's registration, reporting and marketing regimes are increasing. The regulatory burden is already significant compared to other regions in the world.

Taxation:

- Regulatory legislation should always consider and concurrently adapt necessary changes of tax laws; otherwise adverse tax impacts sometimes disable new business opportunities or represent a barrier for economies of scale. Example: mergers between certain funds are legally possible but the tax impact on fund investors may be so negative that fund managers refrain from merging sub-scale funds which could benefit investors.

Distribution:

- If an EEA fund or manager is approved by its home regulator, it should be freely distributable within the EEA to the respective target client groups and be free to manage any fund in any Member State respectively. The pass-porting / notification requirements are a multiplication of work that is quite expensive and there is no obvious added value to that system

- If an EU-wide approval as described above is not possible, harmonization of national distribution/approval regimes is necessary as a second best alternative. For instance, under the AIFMD, distribution has become highly complex with France and Germany having de facto killed private placement by adding very specific requirements while others like the UK or the Netherlands still allow private placement.

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

Stability of regulatory / policy / tax regimes for the infrastructure asset class are key to foster appetite for projects in specific Member States and across the borders. In addition:

- Work to develop the definition of infrastructure as an asset class would be useful to build a transparent and tradable infrastructure market, with a spectrum of investment vehicles comprising a defined asset class.
- Increase access to information on infrastructure investments to facilitate data collection (and thus ultimately funding) and promote harmonisation and standardisation.
- Provide a supportive regulatory and control framework that avoids disincentives to long-term investment (e.g. capital charges disproportionate to risk)
- Look for opportunities in the design of the forthcoming European Fund for Strategic Investments regulation to maximise its attractiveness for international long term investors. Likewise identify how the participation of publicly funded institutions such as the EIB could add more value to project financing.
- All infrastructure assets (and not only a subset of them) should benefit from the same risk-weighting treatment under Solvency II (in order to incentivise institutional investors). In general, infrastructure should have a beneficial treatment versus. traditional corporate securities, as it has proven lower volatility and higher resilience to economic cycle.
- There are also other regulations that prevent a market in infrastructure from developing, such as national restrictions preventing occupational pension funds from investing in long-term infrastructure projects. In 2014, the Commission proposed a Directive (IORPS II) which would, among other things, stop Member States banning occupational pension funds from investing in assets with a long-term profile such as infrastructure, unless the restrictions are justified on prudential grounds; we are supportive of this position.
- The use of public private partnerships should be further expanded within and across Member States (as examples of best practice).

Furthermore, specifically on fostering infrastructure investments standardisation can help:

- An industry standard template: Providing an overview of disclosure and reporting requirements on an initial and semi-annual basis, which should also be used for industry performance data aggregation and analysis including event-based disclosures and public disclosure of compliance certificates, as well as a template for a prospectus / offer document.
- Common governing standard for infrastructure debt (loans and bonds).

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

It is impossible to standardise products for all investor types. It would also stifle competition and the provision of tailored investment solutions for clients. It would be more sensible to look at harmonising marketing regimes for the types of investors (Retail Client; Professional Client; Eligible Counterparty) taking into account our comment regarding redefining investor classification. This would simplify and remove unnecessary regulatory burden and costs.

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

No response.

15) How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

No response.

16) Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

The SFC prioritises the need for global and intra-EU consistency in the conception and implementation of bank prudential standards. We also welcome the establishment of the ECB Single Supervisory Mechanism (SSM) and the Banking Union. The SSM will bring significant consistency benefits to setting implementation and enforcement of bank prudential standards, as will the establishment of the Single Resolution Board for bank resolution policy and execution.

We support the G20, Basel Committee and EU priorities to strengthen bank capital and introduce liquidity and resolution regimes. We note with particular concern, however, the global trend toward ring-fencing capital, which we believe will render the banking system more brittle and at risk, with Total Loss Absorbing Capacity (TLAC) pre-positioning/internal TLAC proposals exacerbating and deepening this trend. We are also concerned by European trends at EU and national level toward bank structural ring-fencing, which we believe is unnecessary given other reforms enacted, and will have counterproductive effects rendering European banks uncompetitive on the global stage, given other jurisdictions are not heading in this direction.

The SFC considers that banks will be better able to support the real economy, especially in liquidity poor countries, if the EU were to enable intra-group capital and liquidity transfers to avoid distortions in the provision of lending between countries. At the moment, local regulators limit the transferability of capital and liquidity between subsidiaries of the same group, meaning banks in liquidity-rich countries place their excess liquidity with central banks, while banks in liquidity poor countries are left to rely on markets. This reinforces distortions in lending rates between countries, pushing up rates in liquidity poor countries, and suppressing them in liquidly rich countries. Whilst we recognise the need to give sufficient comfort to host regulators that group entities in their jurisdictions are robust, it is important to balance this with the need to avoid restricting the flexibility of banking groups to allocate resources, including capital and liquidity, to where they can most productively be deployed. Examples of regulatory requirements that could undermine such flexibility include the subsidiary level MREL under the BRRD, and the potential ring-fencing of EU activity of non-EU headquartered groups under BSR.

Consideration also should be given to reviewing leverage ratio requirements: The Bank of England estimates that a 1 per cent increase in capital requirements reduces secured lending by 0.9 percentage points, and that loan growth mostly only recovers three years after the announcement of regulatory measures. Similarly, the Centre for Economic Policy Research (CEPR) estimates that EU bank assets need to fall by a further 6 per cent to meet market expectations of leverage requirements. The impact on bank lending is substantial and can hinder the banking sector's capacity to support growth. While respecting the priority of international consistency, the EU and its Member States should encourage the Basel Committee to review the impact of the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) in light of the fragile recovery and eventual interest rate rises, to ensure it is fit for purpose.

There should be a review of the treatment of securitisation instruments in existing regulations, such as the Liquidity Coverage Ratio, capital requirements, and Solvency II, to ensure equivalence with other asset classes. Properly regulated simple, standardised and transparent securities can incentivise investment and help finance growth, yet their current treatment in prudential regulation is disproportionately punitive.

Boosting retail investment

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

We believe costs of production and distribution should not be increased by regulation, but rather decreased where feasible in order to ensure supply. Therefore we would advocate increasing cross-border participation in UCITS by seamless, non-complex and unified/mutually accepted distribution rules across EEA Member States (including through harmonisation of the retail market regime and avoidance of gold-plating, in particular for risk-open and sophisticated retail investors – see our comment on investor re-classification) but preferably including non-EEA States such as Switzerland, APAC, Latin American countries where UCITS are already heavily distributed, e.g. based on automatic reciprocal recognition of rules. Opening investment possibilities for retail investors in the ambit of capital markets also means that they need to be allowed, without too high barriers or an overburdening information regime, to invest in riskier products across borders, including for their pensions, although they need to understand and be prepared to take this risk.

18) How can the ESAs further contribute to ensuring consumer and investor protection?

The SFC believes the ESAs should encourage greater supervisory convergence and consistent implementation, and discourage gold-plating by NCAs in the Member States. Some of the consumer information requirements are overly complex, and thus despite plenty of information being available, do not leave consumers better informed. The ESAs could collate and distribute advice and best practice to national authorities on how to better protect consumers without introducing inappropriate requirements.

We believe that with UCITS IV/V, AIFMD and upcoming MiFID II and PRIIPS enough has been and will be done regarding consumer and investor protection. In fact, we face the risk of disproportionate overregulation which might backfire.

Overregulation might also result in a barrier to entry in particular for small fund managers and force medium-sized firms to consolidate, and thus significantly decrease competitiveness and innovation to the disadvantage of investors. In this context we also believe that regulatory consistency and assurance of a level playing field between similar retail investment products is important, be they investment funds, structured products or insurance-based investment products (so called PRIIPs). Retail investors must receive the same high level of protection: what is good for consumers of one financial sector is good for those of other sectors. A uneven regulatory playing field does not benefit investors. As an example, the requirements as standards for consumer protection are not the same in MiFID II and in IMD II (which should accordingly be aligned to the MiFID II standards).

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

We offer some specific suggestions to increase retail investment:

- Lower the bureaucratic suitability tests/documentation for distributors/banks for highly regulated low risk retail products, so that these products can be sold by anyone anywhere without administrative hurdles.
- By enhancing transparency in the documentation on the fund vehicles (risks, costs etc.) in combination with lower duties in the sales process and a guarantee, the products become more easily available to the potential target group

In addition, the Commission should undertake an exercise to abolish all impediments to investment that are not justified by a clear market failure analysis or well considered investor protection objective. There are currently a number of rules in force having little tangible benefit in terms of investor protection. A case in point is the EU's short selling regulation, where we consider that the claimed benefits, in terms of reducing systemic risk, have yet to be clearly demonstrated. Another example is the proliferation of data collection and reporting obligations, where the same transaction may need to be reported under two or more EU directives and each time according to a different reporting and calculation method. Such duplications are implemented by the industry at great cost without any benefit to investors.

The functioning of capital markets can be improved by the provision of more information and financial education, both to savers and investors, as well as SMEs, on what opportunities exist and how to access them. Raising awareness of existing and forthcoming consumer protection will help restore confidence, and begin to overcome risk-aversion to capital markets.

To empower and protect citizens accessing capital markets, we believe educational drive is key. There is a need for programmes to help citizens better understand that long term investment for their retirement, including by investing in capital market products, is essential and beneficial for the economy. Moreover, such programmes can help raise awareness of the available options – UCITS and other regulated collective investment schemes –to retail investors. At the same time state supported pension products need to become more open to capital market products.

More broadly, we believe that retail investments in financial markets will be difficult to increase as long as policy makers do not reconsider the legal basis and treatment of retail investors, in particular sophisticated knowledgeable retail investors. As long as retail investors are given the impression that there is a safety net protecting them from their own decisions, they will not feel empowered to take responsibility for their investment decisions, or build the knowledge and confidence to do so. This is particularly important for increasing pension investment savings, where demonstrable progress has been made in EU Member States that have empowered their pension holders with detailed investment reports on how their pension plans are performing. It should also be noted that investor protection rules currently exclusively focus on protecting investors from risks arising from financial products and therefore ignore whether a financial product may actually protect an investor from risks arising elsewhere, e.g. MiFID imposes great hurdles against a retail investor seeking to protect his or herself against potential future rising interest rates resulting from central bank actions. (See our responses to questions 21 and 22.)

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

Switzerland offers retail investors as part of their pension scheme a tax-benefit so-called “Säule 3a” product, which can be combined with fund investments where you can specify the amount to be invested automatically every month into pre-selected funds in line with an up-to-date risk profile of the individual client.

Attracting international investment

21) Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

As noted in our response to question 1, the EU needs to prioritise taking a lead in reversing the trend towards capital market fragmentation brought about as regulators have retrenched to better manage financial market risks in their jurisdictions. In the wake of the financial crisis, jurisdictions rushed to implement regulations to repair the financial system and better manage risks. However, it is critical that these risks should be managed with a view to preserving the benefits of free trade, free movement of labour and cross-border financial flows. Here we present a number of practical suggestions:

1. Improving internal procedures and institutionalising co-operation with partner countries

As mentioned in our response to question 1, the SFC believes the EU Commission should henceforth take account of the impact of cross-border capital flows in its Impact Assessments when it is developing new proposals. To do this effectively, the views of non-EU partners should be sought in formal policy and regulatory dialogues. Through these dialogues, non-EU partner country authorities should be allowed to play an active and constructive role in the development and implementation of the CMU to help ensure regulatory coherence and avoid closing borders to investors and financial services. The Commission should prioritise engagement with those partner countries most willing and able to contribute to the EU's economic recovery.

Specifically, the Commission should proactively involve third-country regulators in the forthcoming conference on CMU, and in the run up to the development of the CMU action plan to ensure CMU is devised in a way that does not erect barriers around the single market.

In addition, the EU should continue to seek ambitious bilateral trade agreements with key partners to generate enhanced trade flows, with a strong push on financial services.

2. Review existing regulation

Existing regulation, including recent regulation, should be screened for measures that have, inadvertently or otherwise, undermined capital flows within the EU or between it and partner countries. Priorities for review should include:

Collateral

- The single largest downside risk from regulation with material unintended consequences is the cumulative impact of prudential and securities rules on the supply/demand for liquid collateral. If not addressed, it could give rise to a collateral squeeze and inadvertently trigger a systemic crisis. See our answer to Q27 for more details.

MiFID II

- Fixed income full pre trade transparency introduction across bonds and derivatives on a single day, 3rd January 2017, risks re-pricing the entire market overnight and creating market disruption. It is also highly unlikely that industry or regulators can achieve the necessary systems build out in time, without a phase-in.

- Equities 4 and 8% volume caps on dark trading may create pricing and trading strategy distortions and create arbitrage opportunities.
- The third country retail investor regime in MiFID II / MiFIR. This disproportionately denies pass-porting access to all non-regulated sectors, defining them as retail. This should not be the case for sophisticated and experienced individual investors with the capacity to make significant investment in capital markets, as well as for corporates, who should also be able to benefit from the passport.
- New rules on the payment of equity and fixed income investment research and potential related restrictions on the use of commission sharing agreements for equities – will render Europe uncompetitive, reduce investor access to equity and fixed income research and drive parts of the asset management industry offshore.

These provisions would have particular impact for research on SMEs, and thus reduce the willingness of capital market investors to provide funding to them. Non-bank investors currently lack information on SMEs, and investment research can play a crucial role in addressing this gap. Moreover potential impacts in fixed income trading & investment, which does not operate as equity markets, are particularly profound for corporate and sovereign debt. It is therefore essential that a proportionate approach is taken under MiFID II that appropriately balances investor protection with the availability of research across all types of firms.

Client Classification

The broad scope of the Retail Client category in MiFID I and MiFID II includes clients with very different levels of market expertise, experience, and knowledge. These range from basic bank account customers (who need the highest level of protection) to very experienced and sophisticated clients with assets which are suitable for investment in capital markets, often require diversification – including across borders – and who have corresponding risk appetites.

MiFID client classification rules inappropriately prevent such experienced investors from being treated as professional clients, and thus constrain: the choice of instruments they may invest in (e.g. restrictions on access to complex products), the way they can be serviced by investment firms, and their ability to geographically diversify due to restrictive rules on using third-country firms. In the same vein, the new MiFID II third country regime will similarly treat retail clients and those retail clients who have opted for the Professional Client status (elective professionals), should a Member State decide to require third-country firms to establish a branch to provide investment services within their territory.

All these restrictions affecting experienced clients clearly go against the CMU objectives of improving access to financing, increasing cross-border investment, and fostering connections with global capital markets. Consideration should thus be given to reviewing (1) the broad and catch-all class of 'Retail Clients'; (2) the unduly high and inflexible thresholds for undertakings to be classified as professional clients; (3) the conditions to benefit from the elective professional status, and (4) the treatment of elective professionals under the MIFID2 third country regime. Doing so will enable these experienced high risk-bearing investors to contribute to the success of the CMU.

Financial Transaction Tax

There is an inconsistency between the Commission seeking to create a capital markets union, ostensibly to promote cross-border investment, while at the same time undermining it by pursuing the introduction of an FTT. The SFC is concerned by the well documented and potentially severe impact on European sovereign and corporate financing at a time where growth and investment is still weak, see, for instance, *The Impact of the*

EU-11 Financial Transaction Tax on End-Users, *Oliver Wyman (2014)*. In light of this, the FTT should be reconsidered:

- It will distort markets between participating and non-participating countries, undermining investment throughout the EU and from external sources of finance, and the integrated capital market the CMU is supposed to create.
- The wide scope of the proposed FTT is expected to have a severe negative impact on liquidity. In the absence of exemptions, especially in the case of market-making, the effect on trading volumes in derivatives and in the cash market will be negative, not only in the participating Member States, but also for non-participating financial centres as well.
- The costs will have to be borne by end users such as savers, pensioners and SMEs trying to access the market, off-setting the potential consumer benefits of CMU.
- Moreover, these costs to market participants and the real economy of implementing even a limited FTT may likely exceed the revenues generated by the tax.

Securities Financing Transactions

- Limits to collateral re-use may undermine European securities markets and any CMU initiative on collateral framework.

Bank prudential regulation

- Before further steps are taken to implement capital (e.g. TLAC) and structural ring-fencing, consideration should be given to the knock-on effects of deterring investment from outside the EU
- Capital and liquidity regulation impacts on reduced fixed income market liquidity; NSFR impact on equities market liquidity
- Leverage ratio: unintended consequences for incentivising risk investments, dis-incentivising client clearing of derivatives.

Insurance prudential regulation – Solvency II

- Solvency II inhibits and distorts incentives for insurance institutional investors in various capital instruments

<u>3. Taking the lead in developing international standards and ensuring consistent implementation within the EEA.</u>

The EU should, in general, be an advocate for the development of international standards and regulatory principles. Internationally active firms working across borders can facilitate investment by bringing supply and demand for capital. This is especially important when banks are deleveraging, and Europe's non-bank facilitated capital markets are still developing.

To make this process more effective, while also ensuring markets are stable and safe, international standards and practices are highly desirable, but someone has to be an advocate for it, otherwise , as we have seen since the financial crisis, jurisdictions will retreat into local and regional solutions.

The EU, with its long and successful experience of integrating markets between its Member States, is especially well suited for being a leading advocate of global approaches. Working with IOSCO, the OECD, and the Basel Committee on Banking Supervision, the EU should be a leading voice in promoting global principles, and, where appropriate, standards. This includes working with international partners before moving ahead unilaterally.

In addition, consistent implementation and the avoidance of gold-plating is essential. In particular when implementing EU-directives, gold-plating by national legislators should be avoided as it renders efficient cross-market distribution of funds more and more complex and costly (see e.g. the transposition of AIFMD into national laws). The SFC believes the ESAs should encourage greater supervisory convergence and consistent implementation, and discourage gold-plating by national competent authorities and Member States.

4. Actions to further improve the third country equivalence determination process

Timely and predictable equivalence determination of the regulatory and supervisory arrangements in place in third countries is essential to achieve the legal certainty that capital market participants need to trade and offer trading services.

As an immediate action, the most effective approach to provide access to third country firms in a shorter time frame than the CMU is to further improve the equivalence assessment process already enshrined in the context of a number of existing directives and regulations, by pursuing a consistent, outcome-based approach (aimed at evaluating whether the third country regime achieves the same regulatory objectives as the corresponding piece of EU legislation.). This applies for instance to files such as EMIR, AIFMD, or MiFID2/R or BRRD, where consultations with the third country prior and throughout the equivalence assessment process would contribute significantly to an efficient equivalence assessment due to specialist national (third country) knowledge. This approach would also provide relief to the scarce resources of the involved ESAs and the Commission and, thus, might lead to a shortened timeframe for the equivalence decision and assessment.

Further alignment of EU legislation to internationally agreed standards and principles (e.g. BCBS, IOSCO, FATF) would help facilitate and expedite the equivalence determination process. In this respect the Commission should seek close regulatory dialogue and cooperation with foreign regulators to ensure that international standards and principles are transposed in a consistent way across jurisdictions. Recent EU legislation on margin requirements for un-cleared OTC derivatives and on benchmarks clearly illustrate the challenge of regulatory alignment as regulators tend to add their “own finish” to standards/principles agreed at international level.

22) What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?

All of the ideas in our answer to question 21 will help EU firms access markets and investors in third countries. In general, the SFC strongly believes that market access should go both ways, and that partner countries should encourage access to their markets in an effort to make capital markets truly global. The EU should highlight to partner countries regulatory and other barriers, and open dialogue with them about how they might be removed. In many cases, the obstacles to market access may be inadvertent, and could be resolved through closer regulatory dialogue and co-operation. In addition, the EU could facilitate access by including third country markets in measures to promote awareness and understanding amongst SMEs and mid-cap firms on accessing capital markets.

Investing in EU firms could be made considerably easier by limiting access restrictions to the absolute minimum, and revising disproportionate equivalence requirements. Currently, investments in EU firms, for example through Swiss firms, are discouraged in a number of ways. We suggest the following 'hit-list' of unnecessary barriers that can be tackled:

- Some EU third country rules create barriers that make it difficult to invest in the EU. For instance, EMIR and MiFID II exempt intragroup transactions from clearing and trading obligations. However, in a cross-border context, such an exemption is only available where the third country's regime has first been declared equivalent, which is a time consuming and political process. Accordingly, it is punitively costly for a third country to provide financing to EU firms through its EU subsidiaries if it has a corporate structure that relies on transferring risk incurred at the EU subsidiary (e.g. a loan granted by the EU banking subsidiary to an EU firm) via back to back derivatives transactions to the third country parent banking institution.

- The lack of a small bank exemption compared to the US makes it more costly to enter into derivatives transactions with small EU banks as they are subject to the whole EMIR regime.

- Similarly, CRD/CRR contain a number of rules that require positive equivalence determinations to avoid punitive capital treatment. In the context of global banking groups' internal funding flows which often consist of positive and negative balances on both the third country parent institution and the EU subsidiaries balance sheet, this has the effect of making funding into the EU more costly than funding directed elsewhere.

- If EU firms try to raise capital or issue a bond on a third country venue, the third country approved prospectus cannot be used to simultaneously raise capital or issue a bond in the EU. Rather, the prospectus directive requires approval by EU authorities, which materially increases the costs for EU firms to raise capital.

- The market making exemption in the short selling regulation has a negative effect on EU firms trying to raise capital abroad as the SSR has a global reach and the exemption is only available to firms from third countries that have been declared equivalent - which the Commission has so far refused to do even though it has been asked by the industry to do so. We are aware of third country firms ceasing to make a market in securities with an EU underlying trading on third country markets to avoid falling foul of EU short selling rules. Without a market maker it becomes more costly for EU firms to raise capital in third countries.

- There is a lack of clarity under EMIR whether collateral posted at the CCP will be in all circumstances returned to the end client in a cross border context (even within the EU), as insolvency lawyers argue that EMIR did not harmonise national insolvency laws. This uncertainty makes it more expensive to obtain clean legal opinions, which leads to punitive capital requirements when dealing with EU firms.

- EMIR automatically exempts EU central banks from its application scope. For third country central banks, however, no such automatic exemption is available. Rather, the Commission first has to determine that an exemption is necessary based on comparative analysis of the treatment of central banks established in third countries and the risk-management standards applicable to transactions entered into by central banks in those jurisdictions (which the Commission did with respect to the US and Japan and with a planned exemption (only) for Switzerland, Australia, Canada and Hong Kong). It appears difficult to imagine a scenario which does not justify a full exemption for these (and potentially other) third country central banks. Rather, requiring a report from the Commission on risk mitigation on these jurisdictions' central banks appears to be a waste of EU resources.

Improving market effectiveness – intermediaries, infrastructures and the broader legal framework

23) Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

It is important to ensure the proper calibration of the MiFID2 implementing rules, in particular the trade transparency requirements for equities and particularly fixed income, which may otherwise have substantial detrimental impact on liquidity and attractiveness of EU capital markets. The SFC strongly recommends a cautious phase-in implementation of pre-trade transparency to fixed income, where the introduction across bonds and derivatives on a single day risks re-pricing the entire market overnight and creating market disruption. It is also highly unlikely that industry or regulators can achieve the necessary systems build out in time, without a phase-in.

The SFC notes the importance of market-making, as a critical and legitimate mechanism to provide secondary market liquidity. The profitability, and hence viability of market making is under threat from a number of different regulatory changes. Trading assets will be more expensive to fund (the NSFR has the effect of requiring expensive long-term funding for some short-term trading positions), and secondly will become more expensive to capitalise following the Basel Committee's Fundamental Review of the Trading Book, which in conjunction with the capital floors proposals could lead to dramatic increases in costs for market makers. Furthermore, the leverage ratio creates incentives for banks to cut inventory of high quality low yielding securities from their trading books, which further reduces market making and impacts liquidity.

The net result of the above-mentioned prudential regulation will be a reduction in market making inventory from banks' balance sheets, which will also become less elastic leading to increased market volatility in times of stress. These impacts will be further compounded by the introduction of a Financial Transactions Tax, and indeed requirements to hive-off trading activities under the BSR proposal. The successful transition to a greater share of market intermediated finance in the EU, will not be achieved in the short-term, if the calibration of bank regulation undermines their capacity to support market liquidity via market making.

24) In your view, are there areas where the single rulebook remains insufficiently developed?

Reconciliation of existing regulation with the objectives of the CMU is key in the next few years. Unintended consequences of previous regulatory initiatives should be eliminated.

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

The SFC believes that there is more that can be done in this regard. The EU should take the opportunity of the forthcoming European Supervisory Authorities' (ESAs) review to ensure the ESAs fulfil their existing role as overarching system enforcers to ensure effective and consistent implementation of the Single Rule Book by national competent authorities. They need to help raise standards in regulation and supervision in the EU through monitoring financial stability, peer reviews and dissemination of best practice. Additional resources and funding should be considered as acting under the current budgetary constraints threatens to extend the timeliness for the completion of the new EU financial regulatory regime and could lead to sub-optimal standards.. It is very difficult for firms to invest without early clarity on upcoming regulation. Budgetary cuts that lead to delays are highly detrimental.

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

No response.

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

The SFC considers that an adequate supply of serviceable collateral plays a central role in market-based credit intermediation; is central to the functioning of the global financial system, and is therefore key to the success of the capital markets union. Insufficient or immobile collateral can lead to funding stresses that reverberate across financial markets. To address this, regulators should act to clarify appropriate levels of permissible re-hypothecation, transparent collateral ownership, and co-operate to remove barriers to cross-border collateral use.

One of the largest problems in the European markets at the moment is settlement location of the CSDs and no interoperability, e.g. Italian government bonds settle domestically in Montetitoli, French government bonds in Euroclear France. Additionally, financial institutions may, at the same time, have client trades in these asset classes settling into one of the ICSDs e.g. Clearstream. This inadvertently results in banks shuffling securities around between different custodians to settle different trades – thus the settlement efficiency rates are much lower than they could be – and thus collateral velocity ends up being slower. We understand that T2S is supposed to be the main solution for this problem – providing a single platform to settle securities – the roll out of this however has been very slow and scheduled across many waves over 2015 to 2017. Moreover, only after most countries and CSDs are "plugged in" will they then start working on cross border settlement and mirroring of positions. The ultimate outcome would be to allow for the settlement of all bonds in one place and the 'cross border' movements will happen under the hood where institutions are not concerned about these.

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

No response.

29) What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

No response.

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

As a matter of priority, the Swiss Finance Council believes that EU policy-makers absolutely need to avoid introducing measures which are likely to have a negative impact on capital flows and investment, before addressing existing barriers.

In that respect, the Swiss Finance Council notes that there is an inconsistency between the Commission seeking to create a Capital Markets Union, ostensibly to promote cross-border investment, which we fully support, while at the same time undermining it by pursuing the introduction of a Financial Transaction Tax (FTT). The Swiss Finance Council is concerned by the potentially severe impact of such a tax on European sovereign and corporate financing at a time where growth and investment in Europe is still weak. In light of this, the FTT should be reconsidered as:

- It will distort markets between participating and non-participating countries, undermining investment throughout the EU and from external sources of finance, and the integrated capital market the CMU is supposed to create.
- The wide scope of the proposed FTT is expected to have a severe negative impact on liquidity. In the absence of exemptions, especially in the case of market-making, the effect on trading volumes in derivatives and in the cash market will be negative, not only in the participating Member States, but also for non-participating financial centres as well.
- The costs will have to be borne by end users such as savers, pensioners and SMEs trying to access the market, off-setting the potential consumer benefits of CMU.
- Moreover, these costs to market participants and the real economy of implementing even a limited FTT may likely exceed the revenues generated by the tax.

As regards the current tax regimes, we welcome the Commission taking an ambitious approach, including by looking at addressing the deep-rooted long standing issues and barriers that notably prevent efficient cross-border clearing and settlement of securities transactions, as already identified and clearly described by the Giovannini Group in 2003 (Barriers 11 and 12).

Different tax treatment across Member States and between various types of financing poses an obstacle to the development of pan-European capital markets. A large majority of corporate tax systems in Europe favour financing by debt rather than equity by allowing a deduction for interest costs; there is no deduction for the costs incurred in raising equity.

In this respect, the Swiss Finance Council strongly believes that the Commission should consider implementing tax incentives in favour of long term investments, and harmonising the withholding tax regime in Member States with a view to simplify the withholding tax reclaim procedures and facilitate investors' participation in capital markets. The European Commission has previously consulted on various options to reform the withholding tax on dividends. In addition, Member States should consider the tax treatment of certain investment vehicles which can currently, for example, not always benefit from withholding tax exemptions because they do not have a legal personality.

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

Integrated and efficient capital markets call for integrated and efficient technologies. While on the technology side, the API (application program interface) approach to software development is increasingly eliminating the technical boundaries between different applications and systems, local laws and regulations have not yet reached the level of harmonisation necessary to enable the implementation of specific solutions to markets.

This is necessary when reaching beyond a single jurisdiction to make business cases become more interesting given the resources needed to invest in these solutions. The more convergence there is between laws and regulations, the larger is the applicability of specific solutions, the more cost-effective it becomes to develop and invest in new solutions with business models that reach beyond country boundaries. This would foster and nurture innovation and risk appetite to invest therein.

Further, there are technological concepts and solutions already that exist, if introduced by institutions and made available and applicable to the citizens, that would enable and facilitate the digitalisation of many processes establishing certainty and trust as a basis for further development and adoption, e.g. digital ID cards issued by governmental bodies, electronic signatures being accepted, public registers' data being made accessible for checks and consultation in an automated ways etc.

We believe that the full benefit of the CMU can be only achieved through developing and applying existing and new technologies. On the regulatory side, we would welcome the European Commission (like other institutions, e.g. MAS, HKMA) to help create a similar innovation space, funded or non-funded, for actors in the market to cooperate (incl. FINTECH companies) in exploring new technologies and bringing those faster and in a more inclusive way to the market.

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

Safeguard the progress that has been made in capital market integration, ensure proper implementation of new and existing rules, and properly monitor the level playing field. The post-crisis emphasis on strengthening financial stability, especially the highly prescriptive approach in third country regimes, needs to be better balanced against the goal of removing obstacles to the availability and free movement of capital.

Finally, and as some general points, we strongly believe it will be vital for the success of the CMU that there is **a timetable with well-defined responsibilities** for delivering it. The action plan should set out ambitious yet achievable goals alongside timely intermediate steps. Time, moreover, is of the essence. **The time-frame for implementation should be more ambitious**, five rather than ten years. This will require focussing rigorously on the main issues which can actually be implemented, building, initially, in areas where infrastructure is in place and capital markets are working well, so as to give the project greater economic traction. Measures should be simple, non-regulatory where possible, and there should be **an emphasis on both the investor and the issuer/originator side of the equation**.