Executive summary

One of the primary ways in which the EU can serve its citizens is by fulfilling the potential of the Single Market – by making the economy work for the people. To get there, the EU must face a number of challenges that require a concerted and effective response:

- the **ageing of society** is creating a shortfall of payments for retirement;
- **digitalisation** is a game-changer for companies to stay competitive;
- **climate change** could generate unprecedented risks for citizens, governments, companies, and the financial sector;
- a lack of **private sector risk-sharing** hinders a balanced growth in the Member States;
- **trade disputes** reinforce the need for the EU to pull its weight on the global scale to competing in the globalised world.

All of these seemingly diverse challenges have one thing in common: mastering them and turning them into competitive advantages will require deeper, more developed and more integrated capital markets in the EU, i.e. the completion of its Capital Markets Union (CMU).

The purpose of the **Markets4Europe** campaign is to enhance the capital markets' ability to finance **economic growth and employment** in Europe. At their best, markets enable growth through innovation and entrepreneurship; they allocate capital efficiently by providing savers and investors with investment opportunities; they stabilise the economy through private sector risk-sharing; and they provide vehicles for financing sustainable growth. Boosted by market-financing, globally competitive companies can provide the citizens of Europe with better employment and higher incomes.

For the EU as a whole to be globally competitive, the EU's capital markets need to be attractive to savers and investors, from within the EU as well as from abroad.

To create efficient European markets, important challenges need to be addressed, notably:

- a shortage of private pension and similar products, together with highly regulated investment policies of insurance companies and pension funds to invest in risk capital, limits the supply of **long-term capital** to be invested in innovative companies and reduces returns for savers;
- different national approaches to insolvency and asset ownership hinder **cross-border investment**;

- **complexity of taxation** acts as a deterrent for companies and investors;
- companies, especially start-ups, face difficulties in accessing capital markets directly (through **public markets**) and indirectly (through **securitisation**);
- inadequate **financial literacy** on the part of savers as well as entrepreneurs undermines the supply and demand of capital market financing; and
- the **international role** played by the EU is not proportionate to its economic weight on the international arena.

To overcome these hurdles, we recommend the EU, Member States, and the financial services industry to embark on a coordinated campaign targeted at making the following high-impact changes:

- **Channel long-term savings into financing entrepreneurship**

  One of the underlying reasons why the EU has such a limited level of venture capital investments in entrepreneurship is the low level of pension and insurance funds available for such investments. There are two reasons for this: the over-reliance on pay-as-you-go systems in some Member States and the undue restrictions on pension funds and insurance company investment policies. While national choices regarding retirement systems must be respected, there is a benefit in Member States becoming more aware of the links between the financing of innovation and the availability of long-term funding sources such as pension savings. A greater degree of patient capital from long-term providers of funds being invested in innovative companies through pension funds could help savers with higher returns and could finance innovative companies and venture capital funds. Hence, the benefits of funded pension systems (both for investments and for the sustainability of these systems) must be better explained across the EU.

  Separately, the regulation of the existing public and private sector pension funds and insurance companies must be reformed to enable such funds to invest in equity markets, without undue restrictions. Moreover, the regulatory environment should allow to offer better savings products for EU citizens such as EU employees' savings schemes.

- **Make cross-border investment as easy and reliable as domestic investment**

  Lenders and investors naturally prefer investments in countries with high recovery rates, speedier insolvency proceedings and lower costs. Inefficient insolvency proceedings not only reduce investments in such countries, but also dampen cross-border investments. Although a country could attract capital for its companies by improving its insolvency laws, these reforms can be difficult and have not been systematically implemented in the past.

  To attract more investments within the EU, national legislators need to embark on a wide-reaching harmonisation of insolvency frameworks, based on the most

efficient systems to ensure that enforcement is speedy, and creditors' rights are protected. For these reforms to be successful, they should also include capacity building in national judicial systems to accelerate the average times taken by court proceedings.

In addition, cross-border investment would be improved by greater legal certainty regarding the ownership of assets, simpler withholding tax procedures and more efficient operational processes for corporate actions, asset segregation and registration. In all these areas, priority should be given to implementing the recommendations of the 2017 report of the European Post Trade Forum (EPTF), which highlights a broad range of long-standing legal and operational obstacles to efficient cross-border investment flows. For example, reforms are needed to provide more clarity on which securities law applies to determine who owns what asset with harmonised seniority classification of claims across Member States and simplified and harmonised procedures for registering securities.

- **Remove taxation obstacles faced by investors and companies**

Taxes affect both entrepreneurship and savings. On the one hand, corporate taxes must be simple to calculate and neutral in terms of the source of financing. On the other hand, investors must face simple and standardised procedures when investing in their own countries or across borders. Moreover, taxation should not create any undue disincentives to use one type of financing over another.

To simplify the calculation of the tax base for companies in an environment of non-harmonised accounting, developing principles would be useful: a Common Consolidated Corporate Tax Base in the EU would make it easier and cheaper for cross-border companies to expand, based on IFRS accounting that should be encouraged (but remain optional) as a standard across the EU.

As for retail investors in the EU, complex tax frameworks, both within and across borders, are a major hurdle. Withholding tax relief/refund procedures are often so cumbersome and complex that most investors forego the tax reliefs that they are entitled to under existing double tax treaties, which lowers their real returns and further dampens cross-border investment. A saver-friendly and investor-friendly tax system would set the best incentives for savers to invest their money in investment funds and pension funds. Tax systems should therefore have easier withholding tax relief and refund procedures and a simplified tax regime for retail investors.

More generally, the EU should promote the national best practices across the EU that have successfully facilitated retail investors' access to equity markets by simplifying tax processes and in some cases lowering the tax burden. If possible, such practices should be available on a cross-border basis so that retail investors can more easily diversify their investment risks. Member States can also help markets grow by removing tax biases against any form of financing; avoiding a financial transaction tax, which would decrease the returns for savers; and adopting special tax regimes for start-ups and first-time access to markets.

Improve companies' direct and indirect access to capital markets

Capital markets can finance companies directly and indirectly: through public or private markets and through optimal bank risk transfer to capital markets via securitisation. We recommend a number of steps to improve companies' access in both of these areas.

To boost direct access, it is important for smaller companies to become more visible to investors. Their visibility can be improved by promoting platforms that bring companies and investors together as well as by strengthening company research. Existing networks for companies at the pre-IPO stage and investors and market segments for smaller listed companies should be developed further. The industry should also embrace new technologies for improving the efficiency of transactions to the benefit of investors and corporates.

The EU can reinforce the industry's efforts by introducing a comprehensive framework to make smaller companies more visible, by ensuring that the regulatory framework for smaller issuers is proportionate to their size, and by reassessing rules that have discouraged retail investors from accessing capital markets (notably PRIIPs and MiFID II).

Member States can promote the access of companies to markets by privatising and recovering through capital markets, i.e. by using capital markets to privatise outstanding state-owned enterprises as a preferred method of privatisation while ensuring wide and active investor participation.

To promote the indirect flow of capital to companies, banks must be able to transfer risks to capital markets through securitisation, which is the bridge between bank finance and market finance. Banks can play a critical role in the move from a bank-centred to a more market-based financing system, in particular in the financing of SMEs, and also allowing capital markets to enhance cross-border risk-sharing in the EU. In financial regulation, securitisations should be aligned with economically similar products. For this to happen, the EU needs to review the securitisation framework, allow banks to issue/sell loans digitally, and put in place a framework for sustainable securitisation. The industry can reinforce these efforts through a further harmonisation of the underlying loans.

Finally, at the end of the day, the emergence of an effective CMU will also rely on a regulatory framework that allows the European banking system to operate seamlessly across borders and that lets banks fulfil their critical role within capital markets (as intermediaries and as users of markets themselves).

- **Educate the current and next generations of investors and entrepreneurs**

Trust can only be built on knowledge; investment culture can only evolve with investors and entrepreneurs who are comfortable with their choices. We need a major EU campaign for financial literacy to educate the next generation of retail investors and entrepreneurs accessing capital markets. The EU should coordinate the efforts of the ministries of education by providing model curricula, promoting best practice and training teachers, in collaboration with the private sector and academic experts.

- **Strengthen the EU's international role**

To draw upon the full potential of its economy and financial sector, the EU has to develop deeper local and regional ecosystems and improve the interconnectedness of its financial centres further, while remaining open towards other economic world regions. In parallel, as identified by the European Commission in 2018, the EU needs to strengthen the international role of the Euro, for example by developing Euro-benchmarks for commodity markets. In this context, the option of a safe asset could also be useful to consider to improve cross-border investment and stability.

The EU's participation in international financial regulatory dialogues must better reflect the EU's joint interests, in particular the impact on economic growth. This must happen in parallel with a greater convergence of EU regulation and supervision within the Single Market (a further 'Europeanisation of financial supervision') leading to a more consistent supervisory framework for regulated financial services, in a way that respects the proximity of national supervisors to local capital market systems and/or their experience in international debt capital markets.

Structure of the report

Chapter 1 looks at the ways in which the markets can act as the solution to Europe's challenges. Chapter 2 analyses the obstacles to a deeper and more integrated CMU, including the factors constraining the availability of capital to invest in capital markets and those constraining the demand of enterprises for capital. Chapter 3 provides a Roadmap to the Capital Markets Union by actor: EU-level legislative action, coordination of best practices among Member States and financial services industrie action. Chapter 4 concludes with a summary of these recommendations under a call to action to transform Europe's capital markets.

To prepare this Roadmap, a number of CEOs from diverse sectors of the economy were interviewed. For the names of the CEOs, please see the Annex. While the report reflects the general direction of the feedback from these CEOs, not every statement or view expressed in this report should be ascribed to the individuals included here. The German Economic Institute (Institut der deutschen Wirtschaft) has conducted the interviews and drafted the report.