

Markets4Europe: Transforming Europe's Capital Markets

A Roadmap to a Capital Markets Union
for Companies and Savers

Brussels, 27 September 2019

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Foreword

The **Markets4Europe** campaign emerged from a simple goal: to improve the financing of economic growth and employment in the EU by putting markets to work for Europe.

The EU is a vital tool of stability, prosperity and peace in Europe and in the world. At the same time, in a world of changes and challenges, the EU must be in a constant process of improvement while preserving its unique qualities.

As individuals with political and public sector experience in the management of the economy and of finance, we believe that the EU must become better at financing the needs of companies and citizens, in particular by developing market-based financing as a complement to bank lending. We joined forces with 16 CEOs from diverse sectors of the economy – companies, investors, market infrastructures, and banks – and from across the EU to identify the most important reforms needed.

Creating a Capital Markets Union in the EU cannot be achieved in Brussels alone. The EU, the Member States, and the financial services industry must travel on this journey together. That is why we aim to contribute to an open dialogue on the most vital reforms. We hope that the ideas proposed in this report and our outreach through conferences across the EU will help convince EU citizens, national EU policymakers, national governments and national policymakers that these reforms are well worth the effort. We encourage and call upon you to join us in making markets work for Europe.




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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:

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

- ▶ 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 fund managers to invest in equity markets, without undue restrictions. Moreover, the regulatory environment should make it possible 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 and refund procedures are often so cumbersome and complex that most investors forego the tax reliefs to which they are entitled 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. Financial policies 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 banks to 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 to 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 industry 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.

1 MARKETS AS THE SOLUTION TO EUROPE'S CHALLENGES

The EU Member States will face fundamental challenges in the coming years: an ageing society demands a better allocation of household savings; digitalisation will be a game-changer for companies to stay competitive vis-à-vis new challengers; and climate change will accelerate weather-related risks and risks that result from the transition to a CO2-neutral economy, entailing economic costs for citizens, companies and the financial sector. Diverging business cycles in the Eurozone challenge the single monetary policy and a higher level of private sector risk-sharing is needed to balance growth in the Member States. Finally, in times of trade disputes, the EU must represent its Member States in order to ensure fair competition in the globalised world.

These challenges demonstrate that the financial markets of the EU must improve on both the funding as well as the investment side by:

- ▶ financing innovation and entrepreneurship;
- ▶ creating opportunities for savers and investors;
- ▶ promoting stability and risk-sharing;
- ▶ financing the needs of sustainability; and
- ▶ strengthening the EU's self-governance in global competition.

These challenges can only be met with more developed capital markets. A deep and efficient European CMU is the solution to Europe's challenges: savings have to find the best investment opportunities, thereby fulfilling the market's purpose of selecting and financing the best ideas and projects and providing reasonable returns for savers. To fulfil this function, markets should be regarded as an ecosystem of many actors, involving both direct and indirect access to capital markets. For example, only a small fraction of households invests their savings directly in companies, e.g. by owning stocks and bonds; most of them instead rely on intermediaries, such as banks, insurance companies, pension funds and investment funds. This ecosystem of capital market actors can provide retail investors with more stable returns and investment solutions which better fit their individual needs. Companies rely on intermediaries specialised in providing the best financing solution to their individual business model, ranging from private equity and loans to stocks and bonds. Under the right framework conditions, capital markets should achieve the maximum benefit for the citizens.

The deepening of capital markets in Europe would be a win-win for all market participants and for the EU as a whole: for households through a better supply of saving products and for companies through better access to the financing solutions that best fit their business model. Improving the financing conditions of companies will improve their growth prospects which will contribute to job creation from which households will benefit, too. Moreover, more developed capital markets can better channel savings and investments into sustainable activities.



"The Capital Markets Union must be about financing jobs and growth in Europe – markets are the best tool for achieving that goal. It's about providing households with investment opportunities and companies with the best financing solution to their business model."

Stéphane Boujnah
CEO and Chairman of the
Managing Board, Euronext

The literature on finance and growth has come to the conclusion that as economies mature, they transform from a bank-based economy to a more capital market-based economy (Levine, 2005). One reason is that companies reach a point on their growth path at which they need to raise funds from a wider audience of investors, e.g. by issuing stocks and bonds. The other reason is that financing innovative ideas is extremely risky, which may not generate a steady cash flow or involve tangible collateral, and requires the knowledge and the financial means of specialised investors, e.g. venture capital investors, who actively monitor the companies they finance and provide those companies with guidance.

Compared to the US, the economies of Europe are much more bank-based and less capital market-based. The financial market structures in both areas emerged from different institutional set-ups in the past. While European countries relied more on state pensions, the US established a market for private pensions that led to the emergence of large pension funds which act as investors in stock and bond markets and moreover as investors in venture capital. Thus, deeper and more liquid stock and bond markets were able to develop in the US together with a larger supply of venture capital. In contrast to this, in Europe the financing needs of companies led to the emergence of large universal banks (Allen et al., 2004; Allen/Carletti, 2012). Recent data from the World Federation of Exchanges shows that, the global share of market capitalisation of companies in Asia is four times that of the EU27 and the global share of initial public offerings happening in Asia is ten times that of the EU27. In addition to that, more than half of the global equity trading volume takes place on US exchanges (figure 1-1).

When making comparisons with the US or another region, the EU must aspire to bring on board the useful aspects of different models without giving up the positive qualities of its own economic structure. In this sense, the goal should be increasing the role of market-based financing in the EU as a complement to the range of services and financing provided by banks.

Against this backdrop, we can group the benefits of a greater level of market-based financing around the following main topics:

- ▶ during the digital transformation, companies need a wider range of financing solutions to fund innovation and growth;
- ▶ in times of low interest rates and demographic change, savers need access to different saving opportunities in order to achieve the combination of risk and return that best fits their economic situation;
- ▶ Europe needs more cross-border risk-sharing through capital markets to buffer economic downturns; and
- ▶ the EU has to strengthen its global competitiveness.

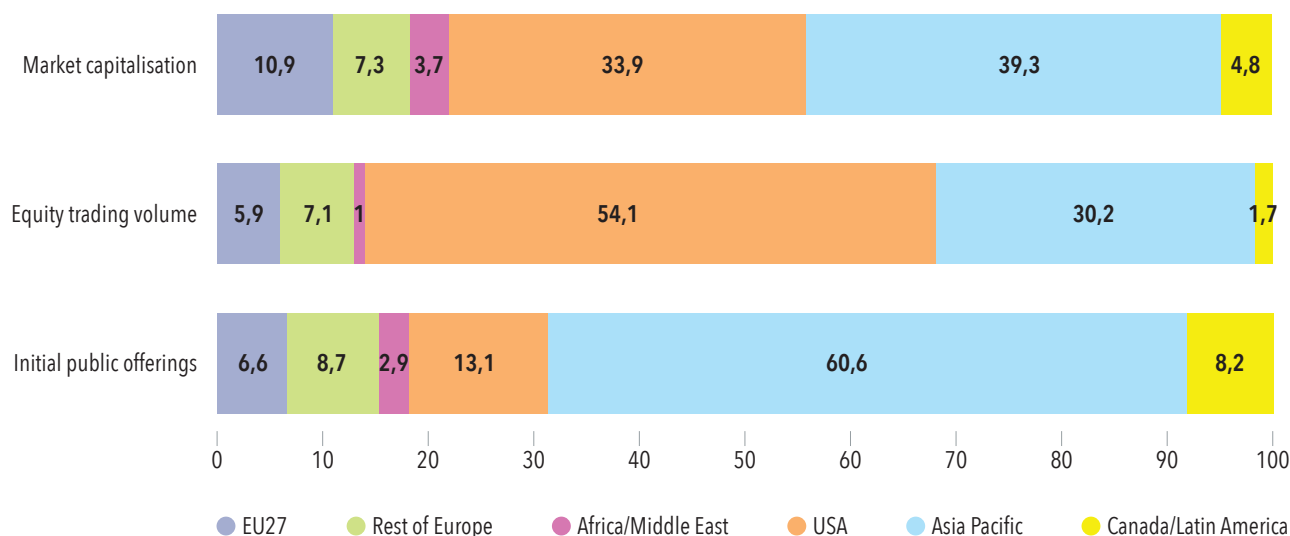
This chapter will take each of these reasons in turn to demonstrate the link between capital market financing and the economic welfare of the EU.



"Europe is the home of hidden champions: small and medium-sized companies that serve the global economy with highly innovative products. To succeed in global competition, companies need access to a modern infrastructure, a competitive tax system, access to a skilled work-force as well as access to the financing solutions that best fit their business models."

Arndt Günter Kirchhoff
CEO, KIRCHHOFF Automotive
Holding GmbH & Co. KG

Figure 1-1: **Initial public offerings, trading volume, market capitalisation**
2018, in percent



Source: World Federation of Exchanges, own calculations

1.1 Financing innovation for growth

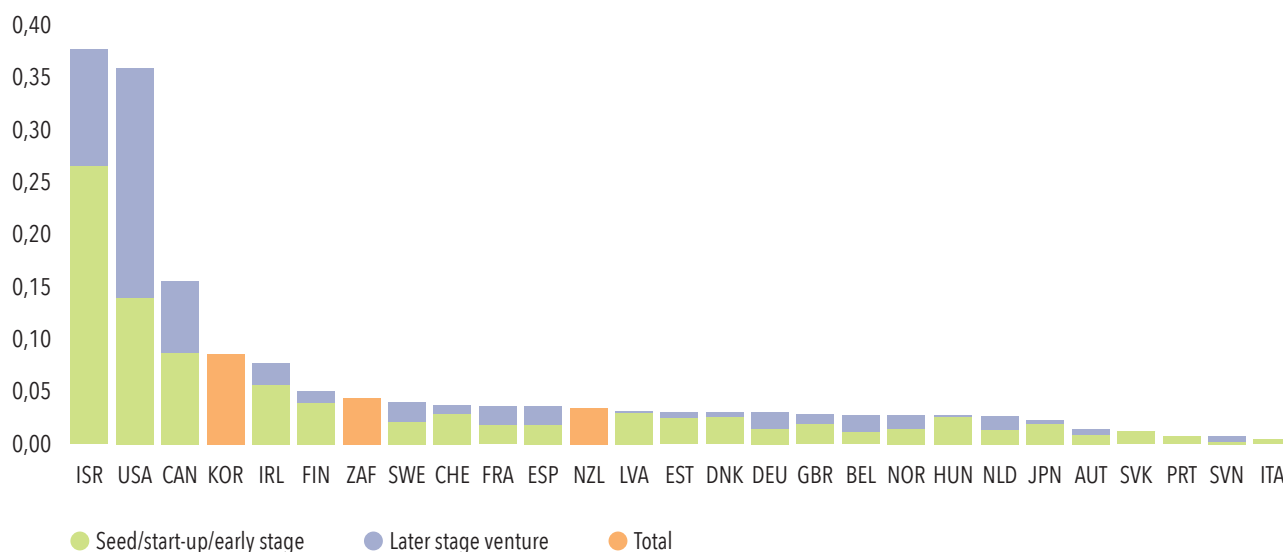
To ensure high levels of employment and growth in Europe and to compete successfully with other economic regions such as the US and China, the EU has to become more innovative. European companies need access to a variety of financing solutions in order to find those which best fit their individual business model and growth phase. When it comes to venture capital investments, European countries lag behind Canada, the US and Israel to a significant degree (figure 1-2). To some extent this variation is caused by the different economic structures of the Member States, but it also reflects the impact of the availability of finance on starting and growing a company. Access to the particular financial instruments which best fit the individual company's age, size and business model is key for its development.

Consequently, improving the financing available to companies can be best achieved by increasing their opportunities to find the optimum combination of different sources of financing. While all aspects of capital markets (equity, debt, public and private markets) are useful for innovation, equity capital is particularly crucial, as it provides initial funding to lift a start-up from the ground and is a pre-requisite for obtaining bank or capital market-sourced debt funding in order to expand. For each step of the "funding escalator", we see two aspects as most important: (1) the availability of equity capital investors and (2) the opportunity for companies to make themselves visible to equity capital investors.

The life cycles of companies show the critical points at which capital markets enable innovation:

- ▶ **Younger and smaller companies at a pre-revenue stage** often struggle to find investors, since these companies are less visible compared to established companies and often lack experience in finding and contacting investors. Helping these companies to become even more visible to early-stage investors is an important step in bringing their ideas to investors willing to invest.
- ▶ **Companies with marketable products and services** can still have unpredictable cash-flows, which makes bank funding difficult (at least without sufficient equity buffers). At this early stage of a company's life cycle, angel investors and venture capital funds are important for providing the company with equity capital that helps the firm to invest in the needed capabilities to sell the product or service to customers. Platforms run by public market operators (see Box) help to bring these inexperienced companies to potential investors and advise them on how to get in touch with possible investors.
- ▶ **Companies with stabilised cash-flows** could utilise loan financing, but a lack of equity capital can still limit access to bank financing. This is particularly the case for companies with newer business models or companies which invest more in intangible assets which are more complicated to use as collateral compared to tangible assets. Bringing these companies and equity capital investors together will help the former access bank loans and other debt instruments.

Figure 1-2: **Venture capital investments**
2016, in percent of GDP



Source: OECD



"SMEs prefer bank lending, but their equity capital ratios are often too low. For SMEs to grow, they need access to equity capital, which helps them to access bank financing."

Jean-Pierre Mustier
CEO, UniCredit

- Larger companies cannot be financed by a single bank or investor alone.** This is the point in a company's growth path, at which it has to approach a wider investor base, e.g. by issuing stocks and/or bonds. By going public the company obtains access to a wide array of investors, i.e. retail investors and institutional investors, at the cost of being subject to stricter disclosure rules and obligations.

Bringing investors and companies together

Industry solutions such as Deutsche Börse Venture Network and ELITE by the Borsa Italiana are successful attempts to bring pre-IPO companies and investors together and to offer guidance and consulting to these less capital-market experienced companies. Deutsche Börse Venture Network is a platform for bringing together young companies at the pre-IPO stage and investors. As another example, Nasdaq hosts regular IPO workshops for prospects and training sessions for currently listed companies.

Once listed, SMEs need to engage and invest time on building investor awareness. For this purpose, exchanges like Euronext and Nasdaq support and organise roadshows in Europe to strengthen the visibility of their smaller issuers towards the investor community. They also publish in partnership with third parties quantitative research notes on small caps. Europe displays a number of successful business stories which must be better highlighted and expanded.

In order to improve the access of companies to finance, the EU has to rethink financing in the form of ecosystems.

- Start-up investors are more willing to invest if there is a liquid exit market.** Therefore, the necessary size of the market for venture capital can only be reached in a unified European market providing deep and wide pools for listing shares in companies and transferring the returns from early/venture/angel investors to the institutional (e.g. pension funds) and retail (e.g. UCITS or direct shareholding) investors.
- SMEs may also access capital markets through bond issuances, as a first step, which allows them to have more transparency, better management skills, culture change, more interaction with investors and international exposure, etc.**
- For many companies, bank loans remain the most convenient part of their external financing.** Thus, securitisation acts as a bridge between bank loans and the markets. In addition, securitisation can help to improve cross-border risk-sharing, when loans from local companies can be sold to global investors who hold diversified portfolios on a cross-border basis.
- Furthermore, in order for a company to grow, it will often need to issue long-term bonds to refinance short- to medium-term bank loans initially taken out.** Such issuance "frees up" capacity of both the company and banks to enter into new loans,

while increasing and diversifying annuity type products available for the EU's institutional investors (e.g. pension funds, UCITS) to invest in, so as to generate returns enhancing the wealth and well-being of the EU's citizens.

- ▶ When it comes to SMEs, global investors often lack information on the companies' business models. Therefore, the availability of widespread and diverse research on SMEs is essential to ensuring greater funding diversification. Changes to the rules on market research, which require stockbrokers to charge investors separately for company research and securities trading, have led to a fall in spending on research, thereby decreasing the visibility of smaller companies and worsening their funding opportunities.

Given the crucial importance of equity capital at all stages of the funding escalator, a question arises: who should be an additional provider of equity capital? A solution would be to favour the development of European pension funds as a complement to existing pay-as-you-go systems, and to allow them to invest more in direct company equity, either directly or via investment funds. The current situation is that insurance companies and pension funds invest only small stakes in companies. Allowing pension funds and insurance companies to invest in long-term risk-capital is the best way to promote venture capital in Europe and thereby the emergence of capital markets for SMEs. The tax system could contribute to market development by supporting equity-financed investments.

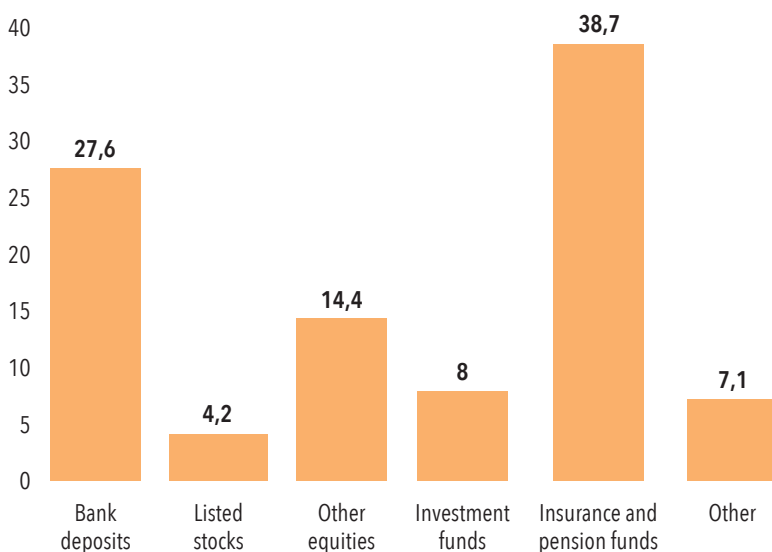
Especially important in the context of innovation and growth is the aspect of financing sustainable growth. The EU has rightly put a focus on sustainable growth



"SMEs and other corporates will increasingly need to diversify their funding sources, and capital markets provide a necessary alternative to bank financing. The listing of securities on regulated exchanges provides full transparency to investors. In this way, exchanges play an important role in mobilising private capital to create jobs and stimulate sustainable economic growth."

Robert Scharfe
CEO, Luxembourg Stock Exchange

Figure 1-3: **Households' asset allocation in the EU**
2018, in percent of total financial assets



Source: Eurostat, own calculations



"Deeper capital markets across Europe should benefit companies and investors alike by lowering the former's cost of capital and boosting returns for the latter. It is critical that those of us who care deeply about securing the future do what we can to increase transparency and understanding of the role that effective market finance plays, and that we work constructively and collaboratively to make initiatives such as the pan-European pension plan (PEPP) as much of a success as UCITS has been."

Andreas Utermann
CEO, Allianz Global Investors

Pre-IPO programmes

In order to help entrepreneurs better understand the role of capital markets and how they can help them reach the next stage of their growth, exchanges have pre-IPO programmes such as FamilyShare, IPOReady and TechShare (Euronext); Elite (LSE and Borsa Italiana); Entorno Pre-Mercado (BME); IPO Workshops (Nasdaq), etc. Those programmes usually support companies contemplating an IPO in the coming two to three years.

and on the need to raise huge volumes of financing for sustainable investments. Both greenfield (from scratch) and brownfield (greening of existing infrastructure) forms of sustainable finance require initial equity investments and ability to issue bonds (to refinance initial loans). All of these will only be possible with a developed and integrated EU capital market.

SME trading platforms

In the last 15 years, European stock exchanges have launched junior markets especially designed to meet the needs of SMEs. These platforms have lighter reporting and regulatory requirements and provide issuers with additional services. AIM, Basic Board and Scale (Deutsche Börse), Access and Growth (Euronext), MAB, and Nasdaq First North are some of the active junior markets operating in Europe.

1.2 Saving and investing in ageing societies

An ageing society has significant implications for the EU's capital markets, as a different allocation of household savings is needed: the average life expectancy in the OECD countries has risen by 10 years between 1960 and the present day, while the retirement age has stayed more or less the same in most countries. The consumption needs in the longer-lasting retirement periods have to be financed by higher savings rates and better opportunities to invest those savings. Given the demographic trends and the persistence of the low interest rate environment, we see an urgent need for providing households with improved investment opportunities.

Because of their longer retirement periods, savers have to channel more of their financial assets into higher yielding asset classes. Whereas well-diversified long-term investments in stock markets could be one solution for savers, most of them do not invest directly in markets but rely on savings accounts. The European household sector holds 27.6 percent of its financial assets as bank deposits and only 4.2 percent of its financial assets as listed stocks (figure 1-3). Direct investments into stocks and bonds require more knowledge about diversification, risk management and taxation. While direct investments should also be encouraged, the indirect participation of households in company growth via pension funds and investment funds appears to be a good option for achieving a better allocation of savings while managing risks. Promoting both domestic and

cross-border asset holdings would increase the opportunities for households to allocate their wealth.

The benefits of long-term stock market investments for retail investors can be seen from the following example: a retail investor who would have started in January 1988 to save 50 euro per month and invest in a Euro Stoxx 50 portfolio would have invested 19,000 euro (with the reinvested dividends), and have gained 56,733 euro in return for dividends and price growth.

In order to encourage households to put more assets into pension funds and investment funds, politicians have to put savers as the end-investors at the heart of policy decisions. This will require looking at the impact of a range of policies on the ability and incentives for savers to invest in capital markets.

1.3 Promoting stability and risk-sharing

The experience of the global financial crisis in 2008/2009 and the banking and sovereign debt crisis in the Eurozone starting in 2010 made it clear that EU Member States need a better cross-border risk-sharing through capital markets, especially equity markets. Risk-sharing has various dimensions: across countries, across market segments, and across economic activities. A deeper and more developed CMU will benefit all of these elements.

In its simplest form, having a financial system composed of both capital markets and bank lending will increase the resilience of the system against shocks. Moreover, the wider the geographic distribution of risks, the greater the stability will be. If one country runs into a recession, but the households and companies of that country receive dividends and interest income from other countries which are not in recession, those incomes could help to stabilise the country in recession. The same holds when a country's banking sector is hit by a crisis and has to restrict bank lending to households and companies. Access to finance will be much easier when households and companies have access to banks and investors in countries which are not in crisis (Cimadomo et al, 2018).

The EU already took significant steps towards promoting financial stability and cross-border risk-sharing through the establishment of the European Banking Union. For example, the resolution of Banco Popular Español showed that the Single Resolution Mechanism of the Banking Union can resolve a failing bank without disruption to the financial system (SRB, 2019). However, the EU as a whole still lacks risk-sharing through capital markets. It therefore needs a higher level of cross-border asset ownership. Overcoming the problem of home bias, which will be discussed in the next section, will be critical to harnessing the benefits of risk-sharing. Limits to cross-border asset holdings come in the form of complex tax rules for cross-border transactions as well as the different degrees of the efficiency of national insolvency proceedings.

Ultimately the EU needs both more private and more public risk-sharing. One potential approach for enhancing cross-border risk-sharing could be through the creation of a European safe asset (see below).



"One of the key priorities of the CMU should be to foster well-diversified long-term investment, crucial to ensure that challenges posed by population ageing and low interest rates are properly addressed. Promoting a regulatory environment that would favour households' investment in capital markets instruments would definitely serve that goal."

Yves Perrier
CEO, Amundi Asset Management



"Withholding tax collection and double taxation are still barriers in the EU which have to be tackled. Investment-Savings-Accounts made it really easy for households in Sweden to become investors."

Lauri Rosendahl
President, Nasdaq Stockholm and
Senior Vice President European
Equities



"Building a Capital Markets Union is not only about financing our companies now; it is about the future and protecting our economy when times get rough. Deeper and more liquid capital markets would act as a buffer in the face of financial turmoil; that's why it is so important!"

Emma Marcegaglia
Chairwoman of Eni, Chairwoman
and CEO of Marcegaglia Holding
and former President of Business
Europe

1.4 Financing the needs of sustainability

Well-functioning capital markets allow companies to find investors for their projects and investors to direct their savings into sustainable activities. Hence, sustainability needs to become a fully integrated part of the CMU project to create resilient and forward-looking capital markets. Capital markets need to embrace the challenges related to climate change and contribute to the reorientation of capital flows towards greening the economy. A liquid market for green bonds serves as a bridge between the long-term nature of green investments and the preference for short-term profits. The reporting and information of environmental, social and governance goals from all listed companies need to help investors take informed investment decisions. Moreover, sustainable thinking, investing and adequate financial products must become the standard of capital markets.

A good example from Europe is the creation of the Luxembourg Green Exchange, a platform entirely dedicated to green, social and sustainability financial products and which lists more than 500 bonds and funds representing over 200 bn US Dollar to date from issuers that range from sovereigns, supranationals, agencies and development banks to financial institutions and corporates. Other stock exchanges also have a significant number of diverse initiatives in the sustainable finance field.

1.5 Strengthening the EU's sovereignty in global competition

The EU is set to lose one of its financial hubs, London, after Brexit. In order to compensate for that loss, the EU has to support the stronger development of ecosystems in the EU and the interconnectedness of its financial centres, so as to strengthen the EU as a competitive global financial centre. Thanks to its appeal and openness to foreign investors and markets, the EU would attract capital and liquidity from abroad.

Stronger capital markets would also increase the attractiveness of the euro as a currency both for investments and for financial transactions, as rightly suggested by the European Commission (COM, 2018). A strong, efficient and attractive capital market, combined with a more strategic EU foreign economic policy, is crucial to enabling Europe to compete successfully with other regions, to promoting the EU's interests in international decision-making bodies, and ultimately to protecting the interests and social characteristics of Europe's economy.

To draw fully upon these benefits, the CMU should be outward-looking and regulated through optimal, proportionate and coherent legislation and convergent supervision. The markets must be liquid, deep and efficient, and free of policies (such as a financial transaction tax) that would further limit or reduce the liquidity and efficiency of the derivatives, bond, and stock markets in the EU. These markets must also include Euro-denominated benchmarks in crucial market segments. A deeper integration of EU supervision practices could also help to build stronger, more integrated and sovereign EU capital markets, and attract investors and companies from around the world.

Over the next few years, the CMU has to be developed further in two ways: the **integration** of capital markets has to be strengthened, since the European market is more fragmented than the rest of the EU's internal market. And the **development** of capital markets must be fostered at both the national and EU-wide levels, since many national capital markets are less developed than the average. Therefore, we provide below our views on the most important obstacles to the integration and the development of capital markets in the EU, under two main headings: factors constraining the availability of capital to invest in capital markets and factors constraining the demand of enterprises for capital.

2.1 Factors constraining the availability of capital to invest in capital markets

► Creating a genuine and effective CMU requires a vigorous role to be played by European banks in financial markets

Banks play a critical role in the move towards a greater share of market-based financing. In the US, this shift began in the 1980s and unfolded over the subsequent decades. It was made possible by: (i) the creation of a truly unified banking system, with the removal of barriers to cross-state-border banks and the subsequent concentration of banks; and (ii) the liberalisation of the activities banks could engage in, making it possible for the largest banks in the US to engage massively in markets, providing a wide range of inter-linked services.

While the EU cannot be fully compared to the US because of the structural differences, the greater degree of fragmentation of the EU banking sector has an impact on the evolution of capital markets. The share of European banks in financial markets activities is even steadily falling (Farah/de Fontaine Vive, 2017). Between 2012 and 2016, the share of corporate and investment banking revenues held by EU banks in Europe, the Middle East and Africa declined from 45% to 38%, to the benefit of their US peers, now weighing 47% of the EMEA revenue pool.

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 play a strong intermediary role within capital markets, as banks are an important element in companies' and investors' access to capital markets, and are users of the capital markets themselves.

► Collective savings schemes are not, even on a domestic basis, sufficiently free to invest in capital markets

A major constraint is the absence of pension and personal savings schemes in many Member States and, where they exist, restrictions on such savings when invested in capital markets, particularly in the venture capital segment that is vital for increasing the ability of companies to grow. While there is a range of factors suppressing venture capital in Europe (for example, the different tax treatment of venture capital investments and the absence of a liquid exit market for venture capital investors due to low IPO activity), in many countries, the

2 WHAT ARE THE OBSTACLES TO DEEPER AND MORE INTEGRATED CAPITAL MARKETS?



"A fair level playing field between the EU and third countries is the key element for ensuring global competition in capital markets."

Johan Thijs
CEO and President of the
Executive Committee,
KBC Group

over-reliance on pay-as-you-go systems and the excessive constraints on the investment policies of pension funds constitute two major obstacles. Moreover, in some EU countries, pension funds do not have the necessary skills or assets-under-management to invest in the real economy.

In addition, the private placements market is fragmented due to different national standards and extensive regulatory requirements for capital raising by private placement, compared to, for example, the US market, where direct capital raising through private placement may benefit in some circumstances from either exempt security or exempt transaction status. Developing private placements further is important for companies to develop capital market experience before issuing bonds in regulated markets. Again, due to the very different legal systems, the market for private placements is fragmented in the EU.

► Cross-border investment and cross-border asset ownership are low in the EU

For collective or retail investors to invest in capital markets, indeed also for banking, the EU Single Market is not sufficiently integrated. For more liquid capital markets, for more private sector risk-sharing, and for better access to corporate lending, the EU has to remove barriers to cross-border asset ownership. The EU's capital market is fragmented by different national tax laws, company laws, securities laws and insolvency laws (including differences in procedural laws and practices), as well as a fragmented system of financial centres. Fragmentation may be exacerbated once London has left the EU. There is the danger that the EU's financial system could become less competitive whilst other jurisdictions may work more pragmatically with less restrictive or more efficient financial market regulation. The existence of numerous financial centres can become a strength for the EU but only if the investor base becomes truly integrated.

A well-recognised hurdle in this area is the heterogeneity of the different national insolvency frameworks, including different procedural laws and practices as well as differing approaches to creditor protection. We can demonstrate the point by looking at two sample EU countries: World Bank data on resolving insolvency shows that resolving an insolvency issue in Italy is much more costly and time-intensive than in Finland (World Bank, 2019). Resolving an insolvency is a complex matter and, to a significant degree, differs from company to company. Importantly, for a cross-border investment decision to be made, it is crucial for the insolvency law of the destination country to enable a high recovery rate in a short period of time, and to avoid a low recovery rate in a lengthy and costly process. Therefore, the national differences in insolvency procedures determine to a significant degree the attractiveness of investments to investors. National differences in insolvency proceedings arise, for example, through the different criteria used for opening an insolvency proceeding, the levels of discretion held by courts to allow the adoption of restructuring plans or change thereof, the priority of claims, the qualifications of insolvency practitioners, and many more factors (McGowan/Andrews, 2018; Huaiyu, 2006). Insolvencies on a cross-border basis are even more complex when there is no recognition of the insolvency proceeding of the debtor's country of residence by other countries (Wessels, 2006). By contrast, investors in the US market - despite some divergence in state-level proceedings and legal complexity of filing in more than one state, on occasions - benefit from a harmonised federal approach to insolvency.

Separately, it has long been recognised that the EU needs a more integrated and harmonised securities post-trading environment, which would reduce the cost of cross-border clearing and settlement, of asset servicing and of other related investor services - a cost that is broadly borne by the end-investors today and creates disincentives for cross-border investment. The barriers are generally well-known and were most recently documented in the 2017 report of the EPTF. Despite this, to date, limited progress has been made in dismantling the majority of these barriers, particularly those for which some direct intervention is necessary from the public sector authorities (at European and/or national level), such as in the case of the legal and fiscal barriers. Of these, one worth highlighting is the lack of clarity on which law applies to determine asset ownership.

► Retail investors do not invest in capital markets sufficiently

A large number of Europe's savers allocate their savings predominantly in low-yielding bank accounts instead of investing in longer-term and potentially higher-yielding instruments such as stocks. Compared with the US, differences are evident: eurozone household's financial assets stand at 215 percent of gross domestic product, compared with 468 percent in the US, and 27,6 percent of such assets are currency and deposits, compared with 12,3 percent in the US. Specific factors contribute to this situation: European retail investors hold more housing assets, less private pension assets, and are more risk averse than in the US.

In addition to this generally low level of investment in any given country, the level of cross-border investment by retail investors is also low. For retail investors to invest in markets, investing across borders is critical to a proper diversification of the risks. (Addressing this obstacle in turn requires steps to be taken to promote cross-border investments, as described in the previous section).

Focusing on the participation of retail investors in capital markets, one important factor is the lack of trust, which affects not only direct retail participation in capital markets, but also the indirect forms of investment available through the variety of collective investment vehicles, like investment funds and pension funds, because it lowers the general investors' demand for access to capital markets. Previous EU actions included various new product classes targeting savers (e.g. the PEPP); however, beyond new well-designed products, what is lacking is a different investment culture, i.e. the willingness of citizens to save and invest long-term, using a diverse range of investment opportunities, such as investment funds and pension funds.

Trust is also intricately linked to financial literacy. The OECD survey on financial knowledge demonstrates that the level of financial literacy remains heterogeneous within the Union and is clearly insufficient in certain areas (Klapper et al., 2015; Mesquita et al., 2016; OECD, 2017). Trust can only be built on knowledge; an investment culture can only evolve with investors who are comfortable with their choices.

In addition to trust and knowledge, retail investors are held back by the complexity of tax procedures for investing in capital markets, domestically or across borders. The returns from investment funds and pension funds could be higher if these investors could reclaim withholding taxes at a lower cost or be



"Europe has to lead in the markets of the future. To strengthen the international role of the euro, we need to ensure that markets of systemic relevance for financial stability, ordinary monetary policy conduct, or the financing of our real economy are sufficiently and appropriately anchored within our own jurisdiction – while guaranteeing a flourishing investment environment from within and outside the EU."

Theodor Weimer
CEO, Deutsche Börse Group



"Given the current geopolitical uncertainty, Europe is well-advised to invest heavily in its payment infrastructure to be less dependent on servers in third countries."

Christian Sewing
CEO, Deutsche Bank

relieved from any withholding tax. The majority of securities is held through a network of domestic and foreign intermediaries and capital market participants. Very few countries have adapted their withholding tax collection and relief procedures to recognise this environment. As a result, the complexity is very high, e.g. more than 1200 different tax forms are required for an investor with a global portfolio, and the tax authorities are often unable to cope with the reclaim volumes. For investors it is often excessively burdensome to make effective claims for withholding tax reliefs or refunds. An additional problem is that the process of reclaiming taxes is frequently based on paper forms and on manual operational procedures.

Finally, the complexity introduced by recent regulations such as MiFID II or PRIIPs does not only discourage retail clients from investing in financial markets; due to unintended consequences, this regulatory complexity also reduces the "client portfolio", reducing the options of certain services with regard to certain clients (the ban on inducements on portfolio management or independent advice is a good example for this).

2.2 Factors constraining the demand of enterprises for capital

It is difficult to set up an enterprise – both in one country and across borders

Decades after the creation of the Single Market, it is (still) difficult to set up across borders enterprises. To be competitive, an EU company must be able to benefit from the Single Market, which requires cross-border entrepreneurial activity to be easy to set up and operate. This is not yet the case because of national differences in company law; businesses face difficulties when they try to set up and carry out all their operations in the Single Market. Digitalisation is an important solution for enabling cross-border activity, but it is not sufficiently widespread. According to Business Europe, there are only 17 Member States in which a fully online procedure for registering companies is possible. Cross-border operations by companies would be cheaper and more cost-efficient if the procedure for registering a company were the same everywhere in the EU, and if more digital tools were used.

Taxation may have a distorting effect on demand for equity

Enterprises are also held back by certain aspects of the taxation of capital raised in markets, in particular, the continuing debt bias (the tax deductibility of interest as opposed to dividends). While this effect may be relative in some cases (e.g. when dividends, albeit non-deductible at the level of the payer, may benefit from a favourable taxation regime at the level of the payee, if not a full exemption), the principle is that taxation of equity could discourage a company from accessing markets when it otherwise would benefit from market financing. In such cases, some innovative projects that could be financed through private or public equity are either not financed that way or not financed at all. To be truly competitive, an enterprise must be able to choose the source of its financing based on the suitability of the financing, and not the tax treatment.

It is also important to avoid taxes that result in undue strains on banks' cost structure and thus impair their ability to finance the European economy. In this context, the impact of the VAT treatment of financial services should be considered, given that the current regime creates distortion and legal uncertainty.

► **Visibility to investors, especially to cross-border investors, is a major hurdle for companies seeking capital**

The ability of the ecosystem (banks, business angels, private equity, stock exchanges, advisers, etc.) to support the enterprises looking for risk capital is key. Over the last decades, niche players in the EU have been squeezed out due to technological and regulatory developments that favoured consolidation. To provide the missing links between enterprises and investors, Europe needs a more diverse range of actors, e.g. more market making and more company research. One acute problem is that company research has become less attractive under MiFID II, because the research costs cannot be passed on to the customer. While the idea behind the reform was to strengthen transparency for investors, it has decreased the incentives for gathering information about companies. The ongoing revision of this issue by the European Commission will be useful in revealing the structural barriers that must be overcome to make high-quality, trustworthy research more available. The financial market can only aggregate information when there are enough incentives for profitable research. Since companies at the pre-IPO stage are less known to global investors, these investors will demand a high-risk premium, making it possibly more attractive for companies to stay private. We believe that the European regulatory framework related to research should be reviewed in order to encourage the production of research, including sponsored research, related to SMEs.

► **Pooling mechanisms such as securitisation are insufficient**

First of all, the EU lacks a legal framework that strikes the right balance. Despite all good intentions, the newly adopted securitisation framework has not yet achieved its objective of jump-starting the market to enable the pooling of high-quality, standardised assets that can be invested in by capital markets investors through securitisation. Although European securitisations had a very low default rate before and after the financial crisis, market activity is now very weak and much restricted. There are also other reasons why securitisation lags behind, which affects both traditional instruments for securitisation, such as mortgage loans, and SME lending. While SME loan securitisation is intrinsically more complex – as shown by its enduring limited expansion including in the US – in Europe, it also suffers from the lack of a common standard for loan documentation which could reduce the complexity of securitisations and improve transparency for investors. The documentation of a loan to a non-financial corporation differs in each of the Member States, making SME loans less comparable on a cross-border basis. Moreover, securitisation is held back by the inability of banks to issue loans and sell loans as fully digital contracts and by capital charges that are punitive for issuers and investors. Finally, the full potential of securitisation for the economy can only be attained if it is put to extensive use for sustainable finance, which requires its inclusion in the framework being developed.



"EU investment banks provide a wide range of intermediation and risk-transformation services in capital markets. For European capital markets to become more efficient and globally competitive, the EU market would need to have strong pan-European investment banks with global reach."

Frédéric Oudéa
CEO, ociété Générale



"Regulatory incentives for investment banks to produce research on SMEs is crucial for making companies more visible to investors. SMEs have to be prepared by advisory services to access market financing, which they cannot do by themselves."

Carlos Manuel Tavares da Silva
Chairman and CEO, Banco Montepio

3 THE ROADMAP TO THE CAPITAL MARKETS UNION



"Standardisation created a liquid corporate bond market in the 1980s. For securitisation of SME loans to work, we need more standardisation in the first part of the value chain, i.e. we need a European loan documentation standard."

Christian Clausen
Chairman, Independent Board
Member, and Senior Advisor,
BlackRock

We believe in market-led solutions to Europe's challenges. A capital market cannot be "built" by regulatory action alone: it can only develop if the demand and the supply for capital market financing exist. However, the public sector can accelerate the development of the capital market by ensuring that an enabling framework exists, by providing the right incentives and by removing unnecessary obstacles. The overview of obstacles in the previous section reveals a number of priority actions that can be taken – or, in some cases, coordinated – at the EU level which could improve the framework faced by the private sector forces.

To provide an actionable Roadmap, we divide the priority areas of reform as follows:

- EU-level legislative actions to remove high-impact obstacles;
- Best practices by Member States which should be promoted across the EU; and
- Action by the financial services industry that can complement EU and national public sector action.

At this point, the remaining legal obstacles to a functioning capital market are of a complex nature and can only succeed with a strong endorsement from the Member States and the European Parliament. Moreover, national legislators need to see the advantages for their countries in adopting European capital market reforms. That is why we believe extensive discussions among all political leaders involving the different ministries are needed to build a consensus on the primary reforms to undertake.

The ambition level must be high; while a long list of low or medium impact actions would also be useful, the time is ripe for embarking on a small number of well-chosen, high-impact obstacles. Below is our priority list, categorised by actions to be taken by the EU, by Member States and industry.

3.1 EU-level legislative actions

Legislative actions to improve cross-border investment

Bank lending as well as investments through the markets can only increase if the outcomes under national insolvency proceedings are more predictable and national insolvency proceedings do not dissuade lenders and investors due to low recovery rates and burdensome insolvency proceedings (figure 3-1). A unified, or at least harmonised, pre-insolvency framework with standardised opening procedures and standards for the seniority of claims would help to overcome barriers to cross-border investment and improve the functioning of the single market and the Eurozone by making it easier to reduce and manage non-performing loans for banks or to resolve cross-border insolvencies. It is important that this harmonisation be 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 time taken by court proceedings. This could also increase the attractiveness of EU companies in financial difficulty for private and public

Insolvency reform: why it must work this time

National legislators might have good reasons to balk at a harmonisation of national insolvency laws because of the complexity of such reforms. However, a sufficient degree of standardisation of proceedings is necessary to achieve a situation in which investors base their decisions on the prospects of their investment rather than the effectiveness of the national insolvency proceeding when investing their money in a country. One way of achieving that could be a harmonised framework for preventive restructurings and creditor protection. The debtor and its creditors would prefer such a pre-insolvency framework if it is more efficient and effective than that of the national judicial framework. In such a framework the conditions for the opening of the proceeding could be harmonised as well as the ranking of claims.

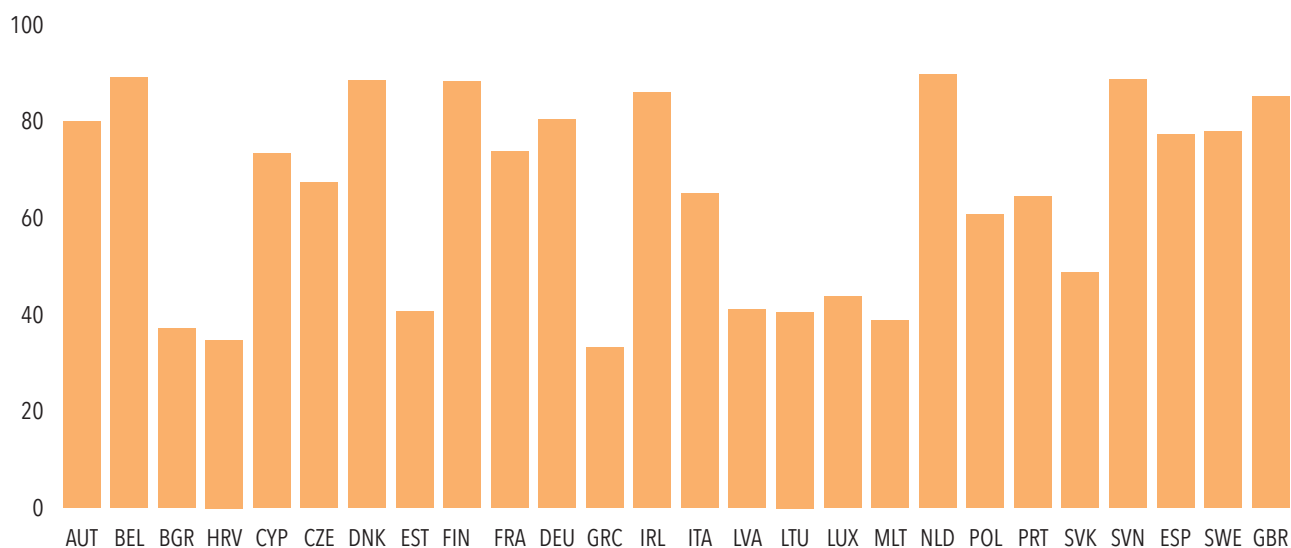
The EU Restructuring Directive, which should be implemented by each Member State by June 2021, could help to mitigate cross-border frictions by introducing a common framework for early restructurings. However, as also indicated by the German government in its public statement, the proposal does "not provide adequate safeguards against abuse and against economically inefficient restructuring attempts. This may lead to the delaying of necessary insolvency proceedings, which in turn may lead to lower rates of return." Thus, some obstacles to the free movement of capital could still remain, although some national insolvency frameworks could be raised to a higher standard. For a true CMU with efficient cross-border investment, all Member States have to implement the Directive in such a way that cross-border frictions are minimised, creditors are protected, and investors face a predictable and efficient framework everywhere in the EU.

turnaround funds which are specialised in investing in companies that need support to recover and restructure.

Secondly, cross-border lending and cross-border ownership can only grow if there is legal certainty on who owns what asset on a cross-border basis. In addition to the harmonisation of loans and the reform of the insolvency framework described above, the EU should provide more clarity on which securities law applies to determine who owns what asset with harmonised seniority classification of claims across Member States, simplified and harmonised procedures for registering securities, or at least which law applies to determine who owns what asset and with which priority of claim.

Moreover, cross-border investment could potentially get a boost from the development of safe assets. Such an asset could (i) offer the opportunity for more diversification in investors' portfolios; (ii) contribute to lower risk in banks' balance sheets, including by reducing the sovereign nexus; and (iii) support the international attractiveness of the Euro. However, this can only be successful if it is based on a fundamentally sound financial policy and greater financial policy coordination in European economic and monetary union, as well as on a well-functioning integrated market.

Figure 3-1: **Average recovery rate across countries**
2018, cents on the dollar



Source: The World Bank

Legislative actions to make securitisation a true bridge between lending and markets

The EU must improve the securitisation framework as a complement to bank lending and direct investment in capital markets. Although the current regulatory framework is still new, there is enough indication to suggest that it may need a major overhaul for it to achieve its original objectives. Such a review must be aimed at removing unnecessary complexity.

The process of securitisation could also be improved by allowing banks to issue loans and sell loans as fully digital contracts. To make that happen, a review of the regulatory framework could include such measures, in order to get more legal certainty over the issuance of digital contracts. Capital charges, which remain punitive for issuers and investors, should also be recalibrated. As an effective tool for risk-sharing, securitisation should benefit from an amended prudential treatment in Capital Requirements Regulation 3 (CRR3) in order to be made more attractive and to play its economic role. The regime applicable to securitisation should be aligned with economically similar products (e.g. covered bonds).

Finally, the use of securitisation for the sustainable finance loans is a necessary path to explore, allowing banks and investors to open up capital currently locked in long-term capital-intensive bank loans for new/additional sustainable investments. For that to happen, we need not only a functioning securitisation framework but also common standards, as part of the EU's taxonomy work, to define sustainable securitisation.

Legislative actions to reduce the tax burden for enterprises

A Common Consolidated Corporate Tax Base (CCCTB) in the EU would make it easier and cheaper for cross-border companies to expand. While governments should always have the right to decide on the tax rates, some degree of harmonisation around the calculation of the tax base could make it easier for companies to do business across the Single Market so long as Member States retain the potential of creating specific incentive structures (e.g. R&D incentives, losses, cross-border loss relief etc.). To simplify the calculation of the tax base for companies in an environment of non-harmonised accounting, developing principles around the calculation of a company's tax base could be useful if done in the right way: the common (consolidated) corporate tax base (such as the one currently discussed) could be useful but should not be determined based on new, stand-alone concepts and principles but rather be derived from IFRS accounting which should be encouraged (but remain optional) for statutory accounting across all Member States. Until a harmonised accounting framework exists, it will be easier to use an opt-in system for the corporate tax base as the original 2011 proposal included. It is also important that Member States retain the potential of creating specific incentive structures.

In addition, there would be great benefit in aligning the Anti-Tax Avoidance Directive, Base Erosion and Profit Sharing and CCCTB, specifically, on elements that would globally foster a genuine level playing field on base erosion and profit shifting so as to avoid the relocation of business activities outside the EU. Here, it would be important to take the specifics of the banking sector into consideration as the sector is already highly regulated, with banks being subject to challenging capital, leverage and liquidity rules and standards in order to reduce the probability of their failing.

Finally, the EU could also encourage the introduction of a special regime for start-ups (e.g. no taxes for the first three years). While many start-ups may not have profits in this phase (and may therefore not be liable for taxes), it would be important to use EU policies towards the goal of harmonising a standard tax treatment that gives all EU start-ups a breathing space before they become liable for taxes.

Legislative actions to make companies more visible

The EU should develop a framework for making companies more visible, e.g. by making it possible to register every business digitally throughout the EU, by providing each company automatically with a Legal Entity Identifier, by facilitating EU-wide trademarks, and by revising MiFID II so that the incentives for unlisted, or mid-cap listed company research would improve.

In addition, the attractiveness for smaller companies to be listed on the stock market should be increased by more proportionality in regulation, e.g. by reducing regulatory burdens that are not necessary to protect the investors of these companies.



"Capital Markets Union remains a relatively unexplored opportunity to increase the connectivity of global markets that can be of significant benefit to smaller local companies and markets, providing them with exposure to increased cross-border investment flows and opening up new opportunities to investors. For this ambitious project to succeed, it needs to go beyond the capital markets and encompass all relevant actors with a wide range of laws and regulations, ranging from tax law to insolvency law to company law."

*Michał Krupiński
CEO, Bank Pekao*

Legislative actions to remove constraints on capital flows

A review of the rules on pension funds, insurance companies and public sector investment vehicles (e.g. development banks and/or municipal and national treasury operations) must be conducted to remove undue constraints on the capital available for investing in public and private equity markets. In this context we welcome the ongoing study of pension systems currently underway. The outcome must be legislative improvements that liberate more pension and insurance funds to be invested in public and private equity markets and facilitate cooperation among pension funds that make it easier for them to invest in the innovative and growing economy.

Conditions for insurance companies to underwrite unrated corporate debt under the approved internal model approach are excessively restrictive and do not reflect current market needs. They should be revised under the 2020 Solvency Revision, so as to allow insurance companies to invest in unrated corporate debt more easily.

Finally, the newly-introduced Pan-European personal pension product (PEPP) framework must be reviewed at the first opportunity to increase its usability across borders.

3.2 Coordination of best practices among Member States

Here we suggest some of the most important reforms which are under national competence and give examples where Member States can learn from each other's positive experiences.

Make taxation more friendly to investors in the EU

Member States should also be encouraged to take a number of steps to make their taxation regimes more friendly to investors. The goal must be to improve national and cross-border investment by a reduction in the complexity of taxation, eliminating tax biases, and providing tax incentives, as follows.

First, Member States must be encouraged to simplify and standardise the withholding tax procedures to encourage more retail participation within a given market and also greater cross-border asset ownership for institutional investors. The EU should promote the implementation of TRACE as a standardised system for claiming withholding tax relief at source of portfolio investments and by applying the proposed electronic format for the information to be reported by financial institutions to tax administrations and for the exchange of information between tax administrations.

Similarly, the EU should promote across the EU best practices such as the Danish/Swedish investment savings accounts which facilitate the stock market participation of households by simplifying the administrative burden of compliance with, and in some cases lowering, the rate of their taxes. If possible, such practices should be available on a cross-border basis so that retail investors can more easily diversify their investment risks.

Finally, any tax bias against equity instruments, where it exists, should be removed in order to increase the demand for equity on the side of the companies, for instance, through the expansion of mechanisms like the “Allowance for Capital Equity” implemented in some Member States. At the same time, tax practices that suppress the banks’ ability to finance the economy, such as the current VAT regimes for financial services, should be reformed.

Withholding tax simplification

The EU Code of Conduct on withholding tax procedures could be improved in the following areas: (1) the need for harmonisation and standardisation, e.g. multiple systems for withholding tax collections and for relief/refund applications cause costs for all actors; (2) international developments, e.g. the (Treaty Relief and Compliance Enhancement) TRACE project of the OECD mentioned above; (3) the wider digital agenda, e.g. the opportunities to replace paper-based forms by electronic or digital signatures; (4) specific issues presented by pension funds and regulated investment funds, e.g. different tax treatment of funds in home country and investment countries; (5) the need for a broader industry engagement, e.g. better solutions for cross-border business by engaging with actors with experience in cross-border business; and (6) monitoring and defining key elements to measure compliance, e.g. an evaluation of laws and regulations.

Best practices in savings accounts

The introduction of investment savings accounts in Sweden has made it easier for households to save and invest in the stock market. These accounts were introduced in 2012 and since then have become very popular in Sweden (and subsequently in other countries).

One advantage for households investing in these accounts is that they pay an annual standardised tax, instead of a capital gains tax, and do not have to report their purchases or sales in their tax returns. The tax is based on their returns each year, which are calculated as the market value of the securities in the account multiplied by a standardised interest rate. Moreover, households have the opportunity to offset capital losses in their tax return against the standardised income in the account. Another advantage for households is that the investment savings account is subject to deposit guarantees, should the institution at which they hold the account go bankrupt. This example shows that a framework with easy taxation can increase retail investor participation in the stock market.

Similarly, in France (PEA), in Italy (Piani Individuali di Risparmio - Individual investment Plans) and in the UK (Enterprise Investment Scheme), regimes exist to support the financing of companies by means of tax reliefs to individual investors who buy new shares in a company. While details may be adapted to countries, the general approach can serve as a model in other countries.

Privatise and recover through capital markets

In countries with outstanding state-owned enterprises, the preferred method of privatisation should be through capital markets, which will both increase the market activity and investor participation. Lessons from previous examples must be studied to ensure wide and active investor engagement.

Make it easier to set up companies

EU Member States must be encouraged to make it easier to establish companies in their territory. A country best practice example is Estonia, which offers an e-Residency for starting a business for people from all over the world. E-Residency is a government-issued digital identity and status that provides access to Estonia's digital business environment not only to Estonians, but also to non-nationals who intend to start a business in Estonia. All of the required steps are possible in a fully electronic form from anywhere in the world. It would be useful to expand this concept to the EU's Single Market.

Encourage SMEs to access the capital markets

In some countries fiscal and legal reform has been pursued to make it easier and less costly for SMEs to issue bonds and enter the capital market for the first time. Best practices across EU member states should be studied and replicated.

How can SMEs be helped to issue bonds?

A best practice to study is the Italian Mini-bond Market. In 2012, a legislative and fiscal reform was launched in Italy which made it possible to remove some obstacles that prevented (or at least significantly limited) the access of unlisted Italian firms to the capital market through the issuance of debt instruments. In terms of tax incentives, the deductibility of the interest paid by the company and the exemption from the withholding tax regime on the interest paid to qualified investors (for securities listed on the regulated markets or multilateral trading venues) were introduced. The reform helped the Italian bonds market to develop gradually. Since 2012, approximately 750 bonds have been issued for a value of € 25 billion. Among them, 650 mini-bonds (bonds with a value of less than € 50 million) have been issued for a total value of € 4.6 billion.

Raise awareness of options for pension system reforms

There are not many pension funds investing in capital markets other than in a handful of EU countries. While national choices must be respected, the benefits experienced in countries that have allowed this kind of investment should be promoted in others, and the development of pension funds should be encouraged, including by tax incentives, as a complement to existing pay-as-you-go systems. The Member States can expand the volume of investment available for capital markets by removing undue obstacles for pension funds and for insurance companies. Member States should become more aware of the options for pension system reforms and the benefits of allowing pension and insurance investments in capital markets.

Expand knowledge of financial markets to create the next generation of investors and entrepreneurs

We need a major EU campaign covering financial literacy to educate the next generation of retail investors and to promote an equity investment culture at the retail level. While this is predominantly an area of Member State competency, the EU should co-ordinate the efforts of ministries of education by providing model curricula, promoting best practice and training of teachers, in collaboration with the private sector and academic experts. This area also has a strong potential for industry action. Please refer to the next section for best practices within the industry.

The financial literacy of the entrepreneurs must also increase. While current macroeconomic conditions may give the impression of financing needs which are not top priority for many companies, one of the permanent structural obstacles for companies, especially innovating entrepreneurs, is their lack of knowledge of financing options, especially through capital markets. Therefore, financial literacy must be improved for the companies as well.

How can Europe educate its future entrepreneurs and investors?

A best practice example is Junior Achievement, which is Europe's largest provider of educational programmes for entrepreneurship, work readiness and financial literacy. The Junior Achievement network in Europe reached last year more than four million young people across 40 countries with the support of 140.000 business volunteers and 130.000 teachers and educators. Financial education efforts for adults should complement these efforts to educate the next generation of investors who are not only digitally savvy but also have a solid basis of knowledge for making investment decisions for themselves, whether on a retail or collective basis.

<http://www.jaeurope.org>

Improve the EU's leadership in global financial markets

The EU Supervisory Authorities and the EU national competent authorities should work together in a progressively more coordinated way with a view to developing a consistent supervisory framework for regulated financial services. Such cooperation will ensure that expertise and knowledge are shared, thereby promoting a common supervisory culture that is based on mutual trust and that respects the proximity of national supervisors with local capital market ecosystems and/or their experience in international debt capital markets.

In parallel to supervisory convergence with the EU, as capital markets are global in nature, the EU should lead efforts on international standard setting (e.g. in FSB, IOSCO, CPMI) and the international regulatory dialogues, with the underlying goal of enhancing the EU financial sector's ability to finance the real economy.

A supporting element would be the development of euro-denominated benchmarks for commodity markets, e.g. liquid gas, hydrogen and emissions-trading, which will attract liquidity to those markets and boost the EU's role in global financial markets.



"In order to create a competitive EU capital market, trading, clearing and settlement layers need to operate seamlessly across borders. The EU must create conditions enabling efficient interoperability across these layers through increased supervisory convergence and a removal of post-trade barriers."

Lieve Mostrey
CEO, Euroclear

3.3 Financial services industry actions

Private sector initiatives can significantly contribute to the development of capital markets. The EU should support these initiatives when there is a need for harmonisation or removal of obstacles to coordinated industry action.

Promote the securitisation of SME loans

Another important reform to support securitisation is the further harmonisation of the underlying loans. A common standard for loan documentation, legal system, insolvency procedures and security claim seniority framework would improve the securitisation of company loans. This would enable capital markets to improve bank lending indirectly. Banks which sell their loans to capital market investors would free their balance sheets for new loans to households and businesses. The standardisation of the documentation of loans, especially SME loans, would enhance their securitisation and the distribution throughout the EU. As a result, cross-border risk-sharing could be enhanced.

Under an optional single loan documentation standard, it would be more efficient and transparent to securitise SME loans, which would allow a more liquid cross-border market to evolve. Arguably, the introduction of a single documentation standard by the private sector contributed more to the development of liquid corporate bond markets than any political action and regulation. There would be a significant benefit in the application of such an approach to the market for securitised SME loans.

Embrace new technologies for improving the efficiency of transactions

Data sharing and data exchange between investors and tax authorities, on the one hand, and between tax authorities, on the other hand, could be improved by a common standard. The Legal Entity Identifier is machine-readable and its use helps to make smaller companies more visible in databases by increasing the comparability of different databases. Thus, full compatibility and coherence between national business registers and records maintained by financial authorities would be essential. The improved transparency would lead to a better matching between companies in the search of capital, and investors in search of investible companies. Moreover, it would make transactions more cost-efficient if there were a common standard for fully digital contracts.

Active industry role in financial education, in partnership with the EU and national governments

For all the reasons explained in this report, it is essential to make the public more aware of the importance of financial knowledge. Financial education is key for savers to be able to invest in higher return financial products while controlling their risk exposure. The industry can play a constructive role in teaching investors – students, households and investors of different ages – the opportunities and advantages of long-term stock market investments and how to manage their risk through diversification, which is important in order to increase retail investor participation. Initiatives such as that of the European Money Week (see Box) could be promoted across countries and across topics to reach a wider range of potential investors and entrepreneurs.

EBF's work on financial education

The EBF has been promoting financial education and financial literacy through various means, including several publications and initiatives on financial literacy highlighting the industry commitment to providing consumers with a sounder understanding of financial services and personal finance. The EBF's work on financial literacy focuses three aspects in particular: savings and debt; cost-of-living and inflation; and risk management. This third aspect is of particular relevance for financial markets, investment funds and pensions.

With the support of its members, the EBF has put in place the 'European Money Week', which takes place every year in the second week of March with financial education activities organised by national banking associations across Europe, under the coordination of the EBF. This annual initiative now involves young people in more than 32 countries, with activities ranging from classroom sessions to seminars and conferences, all seeking to improve financial literacy through better financial education.

A major component of European Money week is the European Money Quiz, which engaged in 2019 more than 100,000 children involving 28 countries in 26 languages. The European Money Quiz was introduced in 2017 by national banking associations across Europe under the coordination of the EBF, together with the international online learning platform Kahoot! as a technology partner. During a financial education workshop for teachers as part of the European Money Quiz activities, the EBF launched the international English language edition of the book 'First Steps in Finance' by Icelandic author Gunnar Baldvinsson. The Icelandic edition was published last year as an initiative by the Icelandic Banking Association and has become a widely used resource in the country's schools. The international edition seeks to provide guidance to teachers across Europe who are looking for ideas on teaching financial literacy.

Industry initiatives to help start-ups and scale-ups to be expanded

Innovative solutions that create networks between start-ups and financiers should be further expanded. These currently take a number of different forms. First of all, there are initiatives by exchanges that are generally aimed at creating a nourishing environment for growing companies. These must be expanded across the EU.

Secondly, networks between investors, business angels, VC firms and start-ups could be improved by giving the companies more visibility.

Thirdly, the current weakness of the European late-stage venture capital and private equity ecosystem could be addressed by encouraging the development of funds of a sufficient size to intervene in 40 million euro to 100 million euro late-stage transactions, for which most funds currently come from abroad.

4 CALL TO ACTION TO TRANSFORM EUROPE'S CAPITAL MARKETS

The purpose of the Markets4Europe campaign is to support economic growth and employment in Europe through a greater use of market-based financing. We believe that, at their best, markets enable growth through innovation and entrepreneurship, allocate capital efficiently by providing savers and investors with investment opportunities, stabilise the economy through private sector risk-sharing, enable the channelling of investment into sustainable activities, and strengthen the economy's competitiveness in the world.

In this report, we argue that the EU, national governments and the financial sector industry must embark on a coordinated journey to implement a number of high-impact reforms to transform Europe's capital markets. Collectively, these actions should create the following changes:

1. channel long-term savings into financing entrepreneurship;
2. make cross-border investment as easy and reliable as domestic investment;
3. remove taxation obstacles to investors and companies;
4. improve companies' direct and indirect access to capital markets;
5. educate the next generation of investors and entrepreneurs; and
6. strengthen the EU's international role.

Below is a recap of the different actions required by the EU, national governments and the financial services industry to achieve these changes.

4.1 Channelling long-term savings into financing entrepreneurship

Towards this goal, we encourage **the EU** to:

- ▶ remove constraints on capital flows through a review of the rules on pension funds, insurance companies and public sector investment vehicles; and
- ▶ promote a regulatory environment favourable to long-term investment that enables the industry to offer better savings products for EU citizens, such as employees' savings schemes.

We encourage the **Member States** to:

- ▶ undertake pension system reforms that expand the pension savings invested by removing undue obstacles, including tax incentives, and limiting existing pay-as-you-go systems.

4.2 Making cross-border investment as easy and reliable as domestic investment

Towards this goal, we encourage **the EU** to:

- ▶ introduce a unified, or at least harmonised, pre-insolvency framework, based on the most efficient systems, together with the coordination of capacity building in national judicial systems to reduce the average times taken by court proceedings;
- ▶ provide more clarity on which securities law applies to determine who owns what asset with harmonised seniority classification of claims across Member States, simplified and harmonised procedures for registering securities, or at least which law applies to determine who owns what asset and with which priority of claim; and
- ▶ improve the broader post-trading environment through the implementation of all recommendations contained in the 2017 report of the European Post Trade Forum, which highlights long-standing obstacles to efficient clearing, settlement and asset servicing in the EU.

4.3 Removing taxation obstacles from investors and companies

Towards this goal, we encourage **the EU** to:

- ▶ complete the reforms needed to simplify the calculation of the tax base of a company based on principles derived from IFRS accounting (which should be encouraged as an accounting standard for statutory accounting across all Member States);
- ▶ reduce the tax burden for enterprises and introduce a special regime for start-ups.

We encourage **Member States** to:

- ▶ support the EU's actions to harmonise the principles around the calculation of a company's tax base across the EU, while retaining the potential of creating specific incentive structures (e.g. R&D incentives, losses, cross-border loss relief etc.), so that it is easier for companies to do business across the Single Market, in particular, by being able to use principles derived from IFRS accounting across all Member States;
- ▶ make taxation more friendly to investors in the EU by reducing the complexity of taxation, eliminating any tax biases and providing tax incentives where suitable;
- ▶ ensure that retail investors are effectively not doubly taxed when investing abroad by improving withholding tax relief and refund procedures; and
- ▶ prevent a financial transaction tax from being introduced, since it would decrease the returns for savers.

4.4 Improve companies' direct and indirect access to capital markets

Towards this goal, we encourage **the EU** to:

- make companies more visible through regulatory refinements, in particular, focusing on encouraging the production of research, including sponsored research, related to SMEs, and the introduction of a comprehensive framework for smaller issuers;
- make it easier to set up companies, e.g. by following best practices which offer an e-Residency for starting a business;
- encourage SMEs to access the capital markets through fiscal and legal reform to make it easier and less costly for SMEs to issue bonds and enter the capital market for the first time;
- reinforce retail investors' ability to invest in companies by reassessing rules that have discouraged retail investors from accessing capital markets (notably PRIIPs and MiFID II);
- make securitisation a true bridge between lending and markets, in particular, by reviewing the regulatory framework, by allowing banks to issue/sell digital loans, by ensuring that securitisation benefits from an amended prudential treatment in CRR3, and that the EU's sustainable finance framework also enables sustainable securitisation to evolve; and
- make sure that overall financial market regulation allows for banks to operate seamlessly in the EU.

Member States can promote this 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.

Meanwhile, the **industry** can help companies access markets and can help expand the scope of securitisation by:

- expanding initiatives to help start-ups and scale-ups e.g. to create networks between start-ups and financiers, by giving companies more visibility and by developing funds of a sufficient size to intervene in late-stage transactions;
- embracing new technologies for improving the efficiency of transactions, e.g. a common standard such as the Legal Entity Identifier; and
- implementing a harmonisation of SME loans that can reinforce the securitisation of SME loans.

4.5 Educating the current and future generations of investors and entrepreneurs

- Towards this goal, we encourage **the EU** to work with the Member States to coordinate a major EU campaign of financial literacy across the EU and in collaboration with the private sector and academic experts aimed at expanding knowledge of financial markets to create the next generation of investors (and entrepreneurs).
- Meanwhile, we encourage **the financial services industry** to take an active role in financial education, in partnership with the EU and national governments, e.g. by teaching investors (students, households and investors of different ages) about the opportunities and advantages of long-term stock market investments and how controlling their risk by diversification is important in order to increase retail investor participation.

4.6 Strengthening the EU's international role

Towards this goal, we encourage **the EU** to:

- improve the interconnectedness of its financial centres, while attracting investors and companies from around the world;
- take steps planned to strengthen the international role of the Euro, for example, by supporting the development of Euro-benchmarks for commodity markets;
- improve the supervisory framework and supervisory cooperation by promoting a common supervisory culture based on mutual trust and recognition of the proximity of national supervisors to local capital market ecosystems and/or their experience in international debt capital markets;
- strengthen EU leadership on international standard setting (e.g. in FSB, IOSCO, CPMI) and in the international regulatory dialogues (e.g. BCBS), with a special focus on the impact of international rules on the ability of the EU financial system to finance the EU economy; and
- consider the option of developing a safe asset, which could strengthen the international role of the Euro while improving diversification in investors' portfolios and lowering risks in banks' balance sheets.

The financial services industry can support this goal by working on the development of Euro-benchmarks for commodity industry markets.

Conclusion

Capital markets have the potential to boost the EU economy and deliver tangible, long-term benefits to the EU citizens. The goal of developing and integrating the EU's financial markets requires reforms at the EU and national government levels as well as coordinated actions by the private sector providing services to capital markets. We are convinced that these efforts will be well worth the resulting benefits in terms of dynamic economic growth, global competitiveness, sustainable development, financial stability and a better distribution of wealth.

In this spirit, we issue this call for urgent action to the policymakers of the EU and Member States as well as the financial services industry.

Let's put the markets to work for the EU economy!

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Annex: List of participating CEOs

- ▶ **Stéphane Boujnah**
CEO and Chairman of the Managing Board, Euronext
- ▶ **Christian Clausen**
Chairman, Independent Board Member and Senior Advisor, BlackRock
- ▶ **Arndt Günter Kirchhoff**
CEO, KIRCHHOFF Automotive Holding GmbH & Co. KG
- ▶ **Michał Krupiński**
CEO, Bank Pekao
- ▶ **Emma Marcegaglia**
Chairwoman of Eni, Chairwoman and CEO of Marcegaglia Holding and former President of Business Europe
- ▶ **Lieve Mostrey**
CEO, Euroclear
- ▶ **Jean-Pierre Mustier**
CEO, UniCredit
- ▶ **Frédéric Oudéa**
CEO, Société Générale
- ▶ **Yves Perrier**
CEO, Amundi Asset Management
- ▶ **Lauri Rosendahl**
President, Nasdaq Stockholm and Senior Vice President European Equities
- ▶ **Robert Scharfe**
CEO, the Luxembourg Stock Exchange
- ▶ **Christian Sewing**
CEO, Deutsche Bank
- ▶ **Carlos Tavares da Silva**
Chairman and CEO, Banco Montepio
- ▶ **Johan Thijs**
CEO and President of the Executive Committee, KBC Group
- ▶ **Andreas Utermann**
CEO, Allianz Global Investors
- ▶ **Theodor Weimer**
CEO, Deutsche Börse Group

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