CMU IMPLEMENTATION

Building an effective CMU for the EU27 post-Brexit

1. Progress made in the implementation of the Capital Markets Union (CMU) action plan

A policy-maker stated that progress on the CMU action plan is not as advanced as it could be. So far, 39 of the 70 action points from the initial CMU action plan and the mid term review have been delivered by the Commission, which indicates that the job is more than half completed. The 39 actions include legislative proposals, 13 of which have been adopted by the Commission but are not yet through the co-legislative process, which means that they have not yet actually been delivered and that some issues remain to be discussed. The Commission has nevertheless delivered a large part of what it had committed to, that is to say the main building blocks that would allow a European capital market to develop. The CMU can only be facilitated in Brussels, but it is up to the private sector and the Member States to actually develop these markets.

A public representative stressed that the European Parliament's main priority is to conclude the legislative work now underway in order to leave as few pending legislative files as possible to the next Parliament. Three main legislative proposals of the CMU action plan have been completed: STS (simple, transparent and standardised securitisation), the Prospectus Regulation and EuVECA/EuSEF. The European Parliament has voted on four other texts related to the CMU: EMIR 2.2, PEPP, CCP recovery and resolution, and the Common Consolidated Corporate Tax Base (CCCTB)[1]. There is still work underway on nine files, some of which are quite far-reaching: the ESAs review and proposals regarding covered bonds, crowdfunding, SME growth markets, sustainable finance, the cross-border distribution of investment funds, cross-border payments, investment firms and the NPL secondary market. It is still possible to conclude the majority of these files by the end of the current legislature, the public representative believed. This should be the case of the PEPP proposal in particular, regarding which there are differences of views between the Parliament and the Council, but none that cannot be solved. It will probably be more difficult to finalize the ESAs review, which raises several political questions, by the end of this term of office although it would probably be possible to reach an agreement on a less ambitious approach.

A regulator considered that the building block approach adopted by the Commission is the appropriate way forward. It is important to realise that capital markets are much less homogenous than the banking or insurance sectors. Efforts are being made since the 1970s to further integrate European capital markets, but progress will always be step by step in this area with a certain element of diversity, unlike the Banking Union which was implemented in one step. An industry representative felt that the CMU agenda is still "alive", which is positive, even if the project needs some improvement and support. Everybody realises that this is not a short-term project. The Financial Services Action Plan (FSAP) that the CMU is building on was launched 20 years ago. Much of the "low hanging fruit" has already been picked with the CMU actions underway. Now there are some more challenging issues to address but it is important to pursue work on this project.

2. Political challenges impacting the CMU

A policy-maker observed that everybody in the EU27 is officially in favour of the CMU and talking about its potential benefits, but there is a gap which needs to be closed between this rhetoric and the action of effectively implementing the related proposals. When negotiating even voluntary codes of conduct, there are often massive levels of resistance, partly from Member States and partly from the industry. The Commission can make proposals, and has done so, but if they are not passed into legislation and not reflected in market activity, the CMU will never be fully implemented. A regulator agreed, noting that building a true union requires abandoning certain elements of national sovereignty and going towards more European approaches, which some authorities are not ready to accept. Another regulator agreed that CMU means sharing responsibilities among EU supervisors, which requires changing the way supervision is organised at the national and European levels, notably concerning the role of ESMA. This should be an outcome of the ESAs review, a large part of which focuses on moving towards more convergent and consistent decision-making at EU level.

An industry representative also felt that CMU must be a priority not only in words and political declarations, but also in practice. There are still challenges in terms of national will, with some policy-makers still questioning the need for a European CMU agenda in the capital markets area. Some growth is happening in EU capital markets when considering the figures of debt issuance in the euro area compared to bank loans (although there has not been much growth in equity issuance). This is a positive development, but it should be further assessed how much of this growth is a result of monetary policy rather than financial regulation or market trends.

Another industry speaker felt that Europe should get to grips with the profound transformations happening at the international level such as Brexit and deregulatory trends in the US. CMU is still considered by many as a "nice to have" project, but these transformations are making it essential. Hopefully the international context will make the CMU appear as a vital project, as was the case for the Banking Union following the crisis, which was implemented in a matter of months.

3. The implications of Brexit for the CMU

3.1. Towards a greater distribution of financial centres in Europe

A regulator considered that the UK's "unfortunate" departure from the single market means there will be more barriers in the future between the UK and the EU27. Additionally, Brexit will change the structure of the European financial market, which is at present very

concentrated in London. There is an on-going trend of relocation of some financial activities to multiple places across the EU. The supervision of these activities is also being split up across different authorities with a risk of ending up with less consistent supervision, particularly if there is an element of competition among financial centres. New tools and approaches are needed to make sure that there is sufficient consistency and convergence of supervision across the EU27.

An industry representative felt that with Brexit the discrepancies in regulation and supervision between EU Member States will be much less tolerable than when most of the capital market was concentrated in London. The CMU will ultimately have to be a harmonising force across EU countries and help to remove domestic barriers. Impetus is however needed at the level of Member States to foster more convergence, otherwise these changes will not be possible.

Another industry speaker believed that the greater distribution of capital market activities across different financial centres in Europe would not be an issue, even though the consequences of Brexit need to be further assessed. This was the case before the City concentrated most of the market and financial competences thanks to the passporting system and the euro in particular and Europe was prosperous then. Additionally, technology creates new opportunities for interconnection and reduces the need for physical aggregation. These changes will increase competition within the EU and provide alternative options. There is an element of rent associated with the concentration of activities in London, the cost of which Brexit will help to reveal.

A policy-maker emphasized that one attraction of having a single financial centre in the EU was that it was de facto supervised by one supervisor and was under one legal framework and one judiciary system. Europe is probably moving to a different world now with multiple points of entry, but in order to be consistent with the single market, there should not be multiple terms. This requires more supervisory convergence. Europe can indeed produce a single rulebook, but if that single rulebook is not implemented consistently across these different centres there will not be a single market. But conversely, if all participants work together on improving the fundamentals of EU capital markets and supervisory convergence, then Europe is in a position to build over time a reference capital market that can also be very open to other global markets.

3.2. Brexit makes CMU all the more important

Several speakers stressed that Brexit increases the necessity of the CMU for Europe. A policy-maker emphasized that there are several reasons for this. First, without the CMU and the UK, Europe would mechanically become even more dependent on banks. Additionally, there is a risk management element to this. An economy the size of the EU27 cannot have the bulk of its capital markets outside its jurisdiction. This means that some level of rebalancing is needed and the CMU project is an important part of that.

An industry speaker agreed that the departure of the UK from the EU is an important catalyst for the CMU agenda. Now that a first inflection point has been reached with the 39 proposals made by the Commission, the priorities ahead for the public and private sectors need defining bearing this in mind. A regulator noted that CMU is a relatively recent project. It was launched when the UK was still in the EU. Some adaptation has been made to the project since the Brexit vote but more is needed.

3.3. Connectivity and openness of the CMU to global markets

An industry representative suggested that connectivity between the EU, the UK and beyond is very important. While Brexit may well be about "burning bridges" between continental Europe and the UK, if Europe wants to be a reference financial centre for the world, CMU cannot go in the same direction, but should on the contrary help to reinforce bridges with the rest of the world. Beyond the question of Brexit, if the EU wants to be an attractive global financial centre, it must be open to foreign institutions and investors. Another industry speaker noted the comments made by a speaker in a previous session about Europe having to decide whether it wants a closed European market or a European capital market which plays on the global stage. A third industry representative underlined that with Europe moving to a system of distributed financial centres, the equivalence regimes governing relationships with third countries need to be reviewed. Equivalence should not be a backdoor for accessing the single market, but a proper flexibility tool. This regime allows potentially everyone to operate within the single market, but this should be done on a level playing field in order to safeguard the integrity of the single market, which is a fundamental pillar of the EU political project.

4. Future priorities for implementing the CMU

4.1. Streamlining and integrating CMU with other European projects

A public representative stressed that streamlining the different initiatives designed to support the funding of the EU economy is essential in order to achieve a really integrated European financial market. A comprehensive policy approach including the CMU, the Banking Union and the EU Invest initiative, together with a review of banking and insurance prudential regulations and taxation and insolvency laws, would provide combined benefits with a multiplier effect. This integration of the CMU with other programmes such as EU Invest was in the philosophy of the Juncker plan from the beginning, but it has not produced its potential benefits so far and without this it will not be possible to achieve all the desired outcome for the CMU. EU Invest, which is a merger of all the financing instruments of the Union into one common fund, could be very powerful. The priority however is to streamline the CMU with the Banking Union because banks will remain crucial for the financing of corporates and SMEs and also as intermediaries in capital market activities. In this perspective, it is essential to break the "political vicious circle" which has so far prevented the completion of the Banking Union and the removal of the barriers to a better allocation of capital and liquidity within the Eurozone. If the Banking Union is completed with the proposed backstop and guarantee on deposits in particular, there will be a stronger element of integration. Achieving this will contribute to CMU because both projects are interconnected. There is no need for a new CMU action plan with a new list of priorities the speaker felt; what is necessary is an effective implementation of the CMU legislative proposals already on the table, which requires granular legislation and consistent implementation across Member States.

4.2. Addressing the fundamentals of the CMU

A policy-maker stressed that since the projects to integrate EU capital markets started in the 1970s there has always been a question about whether Europe should be addressing the fundamentals of the market. These are insolvency law, taxation, ownership rights, consumer

protection and supervisory convergence. In the CMU action plan, these issues are being addressed but only on certain aspects. This is because these fundamentals touch domestic sovereignty and are the areas where it is most difficult to make progress. However, if Member States and the Parliament wish to work in these areas, the Commission will propose appropriate legislation. Obtaining a tripartite agreement between the Parliament, the Council and the Commission could be an effective way to move forward on some of the fundamentals such as taxation and insolvency, as it could help to set the stage for these difficult political decisions. If this is not possible, the Commission will continue to focus on eliminating the frictions on the surface of these different issues to the greatest possible extent. The Commission has for example made one proposal on insolvency in the context of the Banking Union. It is a very modest proposal, based on voluntary action. Yet it was still resisted by a number of Member States who considered it as interference in their rules. We must be realistic. It is essential to address the fundamentals, but these are the most politically sensitive areas to tackle, on which the Commission needs strong political support.

Insolvency laws: Several speakers underlined the importance of working on a more unified EU insolvency framework. A regulator explained that this is essential to facilitate Europe wide debt issuance and the possibility of pooling European debt into securitised vehicles. Progress is needed in that direction once the on-going pipeline of work on CMU is achieved. A public representative agreed, but stressed the complexity of doing so because of national sovereignty. Europe can consider this as a 'pooling of sovereignty', but there must be cooperation among Member States otherwise there will be too much resistance. The speaker suggested that a parallel multilateral mechanism could be built as an intermediate step before a unified insolvency framework, noting that this approach is being used in respect of NPLs.

An industry speaker emphasized that working on an EU insolvency framework will require discussions with Ministries of Justice, who in most countries have their own intellectual framework, different from Finance Ministries. Taking Justice Administrations onboard a project such as CMU is quite challenging, but there will be no choice but to further involve these authorities in the future, because topics such as immigration, security and anti terrorism coordination will have to be priorities for the next Commission. Moreover, if these fundamental legal issues are not addressed, Europe will be subject for the organisation of its capital markets to the will and actions of global markets and foreign jurisdictions. Another industry speaker agreed that the dialogue on insolvency needs to be between Justice Ministers and possibly Prime Ministers. However, the challenge is deeper than that. This issue touches on some highly sensitive political questions such as real estate repossession from households, which will be difficult to tackle for the European authorities.

Post-trading: Two panellists stressed the importance of addressing post-trading issues and notably the Giovannini barriers in the context of the CMU. Progress has been made on these barriers and thanks to TARGET2-Securities (T2S), but the European Post-Trade Forum (EPTF) has since extended the list of areas remaining to be addressed. These include corporate action and general meeting processes, the application of client asset segregation rules, inconsistency of legal frameworks and the inefficiency in withholding tax collection. The two speakers encouraged the EU authorities to tackle these issues in order to move towards more unified processes, without which, some of the harmonized legal blocks required for the CMU would be missing.

Taxation issues: An industry representative considered that the harmonisation of taxation is the most important priority after insolvency, post trade issues and global connectivity. Although it is a very delicate issue, levels of taxation are something which should be easier to fix once taxation processes have been unified at the EU level. Another industry speaker stated that creating a single framework for capital gains should be considered. Tax harmonisation should start in this domain, rather than financial transaction tax. A public representative agreed that tax is always a difficult subject, emphasising the importance of the tax bias between equity and debt. CCCTB will be the first important tool to address this at the EU level. A regulator stressed that taxation is one of the Giovannini barriers in the post-trading area on which the EPTF group has made proposals that need to be taken into account. The regulator added that France in particular would be supportive of examining the question of debt and equity taxation in particular and further assessing how it may encourage the development of capital markets.

Supervisory convergence: A regulator highlighted the importance of supervisory convergence to reach an effective CMU. The effectiveness of a regulatory system indeed depends on rulemaking and also on supervision and enforcement. Significant progress has been made at the European level on the regulatory side with the completion of the single rulebook and the movement from directives to regulations, but this has not been the case in the supervisory and enforcement areas, where proper instruments to make supervisory practices converge are still missing or are not properly used. The level of detail of rulemaking has increased as a consequence, for example with additional Q&As and guidelines published by ESMA. These issues are addressed in the ESAs review, but the regulator remarked that making progress on these topics appears not easy. It now seems as if we need to wait until the next crisis for significant changes to be made to the supervision of capital markets at the EU level, which is what has previously happened with the Banking Union. Making these changes in an orderly way would be clearly preferable. The regulator emphasised that the proposals that have been made concerning ESMA in particular are modest in the sense that they fit within the existing framework of the ESAs. They are only about trying to provide ESMA with the necessary tools to make supervisory convergence more effective and moving a few direct supervision areas to ESMA. Most day to day supervision would stay at the national level. The existing tools at the disposal of ESMA for assessing national supervisory practices (i.e. peer reviews) also need enhancing with more independence, the speaker believed. National supervisors would form part of the teams in charge of these assessments, but the lead must be at the European level for independent assessments to be credible.

Consumer protection: A regulator emphasised the importance of consumer protection. The CMU also requires changing the saving behaviours of retail investors and households, with a stronger focus on capital markets, which requires appropriate investor protection. Regulations such as MiFID II and PRIIPs will help. Achieving the PEPP is also important. Pension plans can be an important driver of a more active participation of retail clients in the capital markets.

4.3. The need to review MiFID II and Solvency II

An industry representative felt that MiFID II is having many unintended consequences that need addressing. A first example is the objective to move liquidity from dark pool and OTC markets to lit and transparent ones which has been bypassed by systematic internalisers, which have created small backdoors that have ended up channelling large volumes of transactions. A second issue is equity research, which is essential for supporting investment decisions with comments on performance and benchmarking. The new system put in place for funding equity research may solve some conflicts of interest on the paper, but has so far resulted in a situation where no one is ready to pay for it anymore.

The industry representative also believed that Solvency II should be at the top of the CMU agenda. The capital charges associated with equity investment must be reviewed, otherwise no insurance company will be able to invest in equity. This is especially problematic in a changing environment where interest rates are due to go up. A public representative agreed that the treatment of equity in capital charges over the long-term needs improving and stressed the importance of the Solvency II review on which ECON is working to define a common position. The upcoming delegated act will be an opportunity to anticipate some elements that might be conducive to CMU. If this is possible, the Commission might be encouraged to take action. At the same time, insurance companies must be better equipped to address volatility in the market.

4.4. Developing SME markets

An industry representative explained that there are different SME markets in continental Europe. Technology SMEs must be considered separately because of their specific profile. They benefit from very strong public support in Europe through the combination of tax benefits, direct subsidies, real estate subsidised by local governments and training, resulting in a strong 'national' dimension of the sector. Despite this support only 10 to 20% of them are strong enough to survive. These remaining companies then require more funding and attempt to raise private equity, consolidate with an industrial company or go to the market. In the case of the latter option, strong technology markets are needed. European equivalents of the NASDAQ, already exist, but critical size is necessary; there must be enough issuers and a sufficient number of investors ready to invest in this asset class as well as appropriate equity research. In contrast to the EU, listing in the US is more expensive and requires presence and visibility in that market. Liability risks for board members are also higher in the US.

The listing of other types of SMEs on public markets is more culturally driven, but it will be increasingly difficult for these companies to be exclusively financed by debt. Many of their leaders also have an incomplete perception of the market environment, because they have never seen an interest rate rise or believe that the money supply of banks is inexhaustible, which is not the case. When the market moves to a more normalised way of pricing debt and equity, particularly in a globalised world, the arbitrage between financing growth with own funds or going to the market will change.

4.5. Sustainable finance

A public representative considered that sustainable finance is another essential area that is being worked on in the context of the CMU. However, finance will not become sustainable solely with financial regulation. Sustainability must also become a priority in terms of governance and be embedded in all the areas of legislation so that it becomes a major component of the political strategy of the Union. A regulator considered that sustainable finance should be one of the key priorities of the next Commission and Parliament, because it will shape the future of the financial market together with other innovative areas such as technology. It is important to have a European approach on these objectives from the outset, because otherwise we will end up with a fragmented situation.

1. The Common Consolidated Corporate Tax Base (CCCTB) is a single set of rules to calculate companies' taxable profits in the EU. With the CCCTB, cross-border companies will only have to comply with one, single EU system for computing their taxable income, rather than many different national rulebooks. Companies can file one tax return for all of their EU activities, and offset losses in one Member State against profits in another. The consolidated taxable profits will be shared between the Member States in which the group is active, using an apportionment formula. Each Member State will then tax its share of the profits at its own national tax rate.

Effectiveness and integration of the EU fund sector

1. Development opportunities of the EU fund sector

An industry representative underlined the importance of considering the needs of retail investors, when assessing the development opportunities of the EU investment fund sector. The average EU household holds approximately 10% of its financial assets in funds and three times as much in cash accounts, which currently generate negative real returns. Funds on the contrary generate positive returns over the long-term. Secondly, longer life expectancy is increasing the need to plan for the long-term in a context where the role of pay-as-you go schemes is diminishing. This long-term investor outlook creates many opportunities for the fund industry. In addition, the funding needs of the EU economy represent further opportunities for the fund sector, as capital needs deploying in the economy. It is unlikely that the banks and the public sector will be able to entirely fill this gap. The real economy and the financial industry are also becoming more aware of the need to think with a longer term and more sustainable perspective and the fund industry can help to channel and allocate the capital that is needed to support that approach.

An investor representative believed that the fund industry is in a strong position to support the objective put forward in the context of the Capital Markets Union (CMU) initiative to shift more money from cash to the capital markets. Significant changes have taken place in the fund industry such as cost reductions, efficiency improvements, an enhancement of product ranges and an improvement of the regulatory level playing field.

Another industry representative emphasized the opportunities for the EU fund sector created by the European Commission's sustainability action plan. Many EU-based asset managers have indeed been at the forefront of developing environmental, social and

governance (ESG) investment approaches and more than 80% of the EU sector's assets are embedding ESG criteria. New technologies also present a key opportunity that asset managers need to take on-board.

A third industry representative noted the stability of the EU fund sector and the growth in particular in the demand for and supply of private equity and infrastructure financing. These positive trends will hopefully continue and should be taken advantage of to develop the sector with the support of an appropriate regulation.

2. Challenges facing the EU fund sector and areas of improvement

2.1. Cross-border distribution and supervisory convergence

A regulator stressed that investment funds are probably the financial sector where EU product regulation has been the most successful, with UCITS, which has become a standard at the global level and a model of regulation. Another regulator agreed that the EU fund sector is in a good position in terms of regulation, but felt that there is still room for improvement, notably regarding cross-border distribution within the EU. For example, the passporting regime of the Alternative Investment Fund Managers Directive (AIFMD) does not seem to function optimally, with unnecessary requirements and fees added by some national competent authorities (NCAs) that hinder the cross-border distribution of these funds across the EU. There is a question as to the appropriate level at which that issue should be addressed. Given the strength of the regulation of the sector, now is the time to move towards more supervisory convergence, the regulator believed. This does not require transferring all the supervision to ESMA but rather implementing the recommendations that have been made in the review of the European Supervisory Authorities (ESAs), which the speaker fully supported. It may however be prudent to clarify first a certain number of regulatory issues at the EU level in order to facilitate supervisory convergence. This does not require implementing new regulation but eliminating hurdles to the consistent implementation of existing rules.

An investor representative suggested that the fund sector should be the starting point for further developing an integrated EU capital market. This however requires investors to be provided with the products they need. A regulator expressed support for the idea of using funds, one of the most integrated sectors in terms of regulation but one of the most disintegrated in terms of supervision to test the implementation of further supervisory convergence with the backing of the different EU institutions. The regulator noted that there is a difference in the buying power of investors across the EU: in certain countries consumers have the possibility to invest in a wide range of products, but in others, the range of products is limited by banks or insurance companies that mainly distribute the products of their asset management subsidiaries.

An industry representative supported the principle of supervisory convergence but stressed that this should not mean carrying out all supervision at the EU level in a similar way. The principles of proportionality and subsidiarity need to be maintained. Cross-border distribution involves managing a certain level of complexity and the NCAs in Luxembourg and Ireland have built significant expertise in dealing with that complexity over the years.

Another industry speaker stressed that the existing EU fund framework is appropriate to ensure the continued success of the sector and is supported by significant supervisory experience and expertise at Member State level that fosters certainty for both fund managers and global investors. Many international asset managers choose the EU as a domicile for their funds because of this experience and expertise in supervision and the certainty it provides. The ESAs may support the NCAs in further developing and implementing best practices, but imposing direct supervision does not seem appropriate.

2.2. Issues raised by PRIIPs

An investor representative considered that some regulations that affect retail investors and the fund sector still need improving. It is essential that retail investors understand, at the point of sale, the products that they are buying and their costs. PRIIPs (the packaged retail and insurance-based investment products regulation) aims to provide investors with the information they need for making appropriate investment decisions, but it raises significant concerns, as it may result in restricting the range of products that retail investors can invest in. The possibility that UCITS and PRIIPs requirements could merge somehow in 2019 is also raising many questions amongst investors. This is unfortunate because the point has finally been reached where many retail investors are starting to understand how UCITS funds work and how to compare costs and performance data, even though some difficulties subsist, and PRIIPs may create some confusion in this context. PRIIPs has also resurrected the debate about product costs (i.e. what are the product costs that need disclosing and how they should be disclosed), but there has already been a detailed assessment of these questions in the context of MiFID. The costs to disclose have been defined in an ESMA ruling, as well as the way to implement cost disclosure requirements. Another concern is that retail investors who finally decide to take the step from holding cash to investing in capital markets are sometimes dragged into non listed products that have implications that are difficult to really assess and monitor, even for supervisors. Listed products or investment funds at least follow a common framework.

A regulator agreed that PRIIPs has given rise to unintended consequences. The intention was sound, but the project has somewhat derailed along the way. In particular, the coalescing of PRIIPs and UCITS packages that this may lead to is unwanted. This needs to be further assessed and resolved as soon as possible. Another regulator agreed that the interactions between UCITS and PRIIPs need clarifying and solving in a pragmatic way.

2.3. Brexit implications and competitiveness issues

An industry representative emphasized that the UK's decision to leave the EU creates further challenges for the EU fund industry. A first potential issue relates to delegation rules which allow UCITS to benefit from cross-border access to the world's foremost portfolio management talent within and outside the EU. This needs to continue in order for UCITS to maintain its position as the global fund vehicle of choice. If portfolio management has to be undertaken in countries selected for 'political' reasons, portfolio management talent will be diluted. A second risk arising from Brexit is an increased cost of delivering fund products to investors, which will impact not only EU investors but also global investors in UCITS products. Currently, European investors benefit from a full spectrum of product offerings. However, if distribution between the UK and the EU is disrupted, the increased costs of offering all fund products in individual Member States together with limitations already occurring as a result of PRIIPs will inevitably lead to a

more limited range of products offered, particularly for investors living in the less wealthy EU States. A regulator commented that it is however inevitable that costs will increase because of the element of EU disintegration that is inherent to Brexit.

Another industry representative agreed that the UCITS gold standard that has been established in Europe should not be threatened by changes in rules. In addition, regulatory or supervisory evolutions should not change successful business models unless there are very good reasons to do so. Outsourcing and delegation are key components of the sector's success and bring benefits to investors. Significantly changing this will undermine European champions and reduce investor access to certain asset classes.

Moreover, a third industry representative stressed how important it is for the EU asset management sector to remain competitive at the global level. There is indeed a decline in the number of large European players in the asset management space. 10 years ago, 10 of the top 20 worldwide asset managers were based in the EU. Now, only five are. It is essential that the European sector should remain efficient, and the way regulation is adopted and updated plays a role in this.

3. Possible need for regulatory evolutions in the fund sector

3.1. No need for additional fund regulation in the EU in the short-term

The panellists considered that the priority is not to propose new fund regulation in the EU but rather to optimize the existing framework and its consistency across the EU.

An industry representative stated that EU fund regulation is generally perceived to be 'ahead of the curve' at the international level, for example in terms of liquidity tools, and this advantage must be maintained. UCITS and AIFMD, the two cornerstones of EU fund regulation have already proved their capacity to ensure the resilience of the sector during the tumultuous post-crisis period and following the results of the Brexit referendum. Before making any further regulatory changes, the EU authorities should first wait to see if any further actions are envisaged at the global level. The Financial Stability Board (FSB), after having recommended improvements of the fund framework at the global level following the financial crisis is now assessing the implementation of the newly adopted fund regulations across the different G20 jurisdictions. In the US, the Treasury has called for a 'lighter touch' regulation in the fund sector, which should also be borne in mind.

A regulator stressed that UCITS V and AIFMD have put the EU fund sector in a better position. These frameworks have led to an improvement of the efficiency and the depth of EU fund markets and a reduction of the cost of investing which have allowed the broadening of investment opportunities and the enhancing of the allocation of capital in the EU. Some hurdles however still need eliminating at the cross-border level. An investor representative also emphasized that the current obstacles to cross-border distribution, product availability and delegation need eliminating. Fostering a truly European fund market will eventually lead to lower prices and better products.

Another industry representative suggested that asset segregation and reporting requirements for example also need clarifying, as well as the consistency of the terminology that is used, which creates uncertainty. For example, terms such as 'investor', 'beneficial owner' and 'ultimate beneficial owner' which are often used in an interchangeable way should be specified in order to improve legal certainty particularly in a cross-border context.

3.2. Reviewing the legislative approach used in the fund sector

An industry representative was concerned that the incoming Commission and Parliament might be tempted to launch new legislative actions at level 1. Instead of reopening UCITS or AIFMD, which already constitute an efficient framework and possibly 'reinventing the wheel', there should be more focus on level 2 and 3 measures to adjust some 'technical details' of the existing regulations and improve their convergence across the EU. Most of the remaining practical issues that market players and investors are suffering from can indeed be solved at level 2 or level 3, the speaker believed. More generally it is necessary to better differentiate what is addressed at each level in order to optimize legislative processes and the use of the respective competencies and experience of policy-makers, regulators and supervisors.

A member of the audience underlined that while the US Treasury was able to assess the whole post-crisis legislation and make suggestions for changes in one step, this is more difficult to do in Europe where every single piece of EU legislation has a different review clause with a different due date. The asset management sector alone is directly regulated by eight pieces of legislation alongside other ancillary regulations that also impact the sector. This multiplicity of rules also requires serious consideration.

The industry representative also criticized systematic review clauses. There may be political reasons for such clauses and requests for an early review made by some stakeholders who have not obtained all they wanted in the previous version of the text, but these systematic reviews are very difficult to manage for market participants because, due to the length of EU legislative processes, reviews are often launched shortly after a regulation has been implemented. This is the case for EMIR for example. In addition, making reviews less systematic would allow ESMA to play a greater role in the improvement of EU legislation on its own accord.

Another industry representative added that Q&As drafted e.g. by ESMA can solve many issues. Speeding up the pace of Q&As is however necessary. Another improvement in terms of legislative approach would be for new principles to be tested all along the value chain, including with intermediaries, before a regulation is enacted. Once the rules are enshrined, it is indeed difficult to amend them. One area where this needs to be done for instance is time limits, which create significant difficulties and constraints for the industry, especially when processing historical data.

A regulator agreed that Q&As are an effective tool which allows tests to be performed along the value chain. However, whether such tests should involve the private sector still needs to be determined. In addition, Q&As cannot be a substitute for legislation, because they do not provide the same safeguards. An investor representative was in favour of asking the consumers and the industry for their input during the consultative work led by ESMA, particularly in relation to the drafting of Q&As.

Developing EU securities markets: SME listing package, corporate bonds

1. The importance of developing SME equity markets and IPOs

An industry representative underlined, with a description of the benefits provided by initial public offerings (IPOs), the economic importance of developing SME equity markets, which should be one of the key objectives of the Capital Markets Union (CMU). IPOs have a very positive social impact as job creators and thus contribute to economic growth. A number of studies show that 90% of all revenue and staff growth occurs after a company lists or completes a successful IPO. IPOs also provide investors with positive investment performance (i.e. 'alpha'). Studies show that IPOs through multiple cycles, on average, outperform underlying benchmarks by as much as 500 to 700 basis points. This is therefore an important investment tool not only for institutional but also for retail investors.

However, over the past 20 years, there has been a significant decline in IPO volumes. Issuance numbers have decreased by 70% since their peak in 1999, particularly for SMEs. There are both structural and regulatory reasons for this decline. On the structural side, there is an abundance of private equity and venture capital in the system, which means that companies are staying private for longer. From a regulatory and efficiency perspective, the IPO process is still cumbersome, involving extensive manual processes, and also very costly (in some markets the IPO fees are between 6% and 7% before legal fees).

A regulator stressed that the diversification of the funding sources of SMEs is an important objective of the CMU. Developing instruments and funding structures that may support the innovation and growth of these companies is absolutely essential. MiFID II introduced the concept of SME growth markets but there has not been a significant uptake of these markets so far. An industry representative added that 75% of what are considered to be growth companies are working with intangible assets, which requires a specific funding approach involving private equity and public markets.

2. Main obstacles to the development of SME equity markets

2.1. Liquidity issues

Several panellists stressed the importance of liquidity for the development of SME equity markets.

'Both sides of the equation' (i.e. investors and issuers) should be looked at in terms of the development of SME markets, a regulator emphasized, and liquidity is particularly important when it comes to attracting investors. There is also a link between the liquidity and reputation of stocks which is crucial for market confidence because the absence of liquidity may lead to a downward pressure on market prices and significant losses in stressed market situations. This may happen for example if several funds are over-invested in SME stocks and many redemptions happen at the same time. Usually, only a limited number of investors are impacted by such events, but this has negative impacts on the image of these markets.

Another industry representative agreed that liquidity issues have significant implications because SMEs are part of an ecosystem that includes not only the listed SMEs but also mutual funds and other investors investing in these stocks. The limited liquidity of SME stocks however means that caution is required in relation to the development of SME markets. There are at present only 3,000 listed SMEs out of a total of 3 million in the EU but having many more could create systemic risks if these are illiquid. The obstacles to enhancing liquidity in SME markets have to be eliminated for a further development of these markets, even this is a challenging task, the speaker emphasized.

2.2. Other issues related to research availability and cultural factors

Several other issues that hinder the development of SME markets were mentioned by the panellists. An industry representative was concerned by the difficulty of funding research on SMEs following the implementation in particular of MiFID II rules that require the unbundling of research costs. Brokers are reducing their research activities because they are no longer profitable enough and analysts are disappearing from the market. Research needs to be incentivised, especially in the SME segment, where it is a key driver of investment decisions. A regulator stated that although there is currently a great deal of debate about the impact of MiFID II on research, it is still too early to measure the effective outcome of these measures and monitoring of this should continue. It is also necessary to distinguish the quality of research from the quantity produced. What is needed is sufficient good quality research that covers the right type of companies. Research needs to be sufficiently spread out as opposed to everyone reporting on the top 50 companies. An industry representative added that 'real' research needs to be re-developed, as opposed to research paid for by the issuers, which raises objectivity issues.

A regulator also highlighted the importance of cultural factors. Most SMEs are not inclined to seek funding on the capital markets. Efforts should be made, including with incentives, to change that mind-set and make capital markets more attractive for SMEs.

3. Proposals made for developing SME equity markets

3.1. The SME listing package, a first step that needs completing with more structural measures

Several speakers welcomed the SME listing package proposal recently made by the Commission aiming to make MiFID II SME Growth Markets[1] more attractive. SME Growth Markets (SME GMs) have so far not generated much enthusiasm with only three venues registered as such, out of the 40 that could qualify in the EU. According to the Commission's impact assessment this is due to the insufficient alleviation that is provided at present from Prospectus and Market Abuse Regulation (MAR) requirements, the lack of authorized mechanisms to promote trading and liquidity on SME GMs and an inadequate definition of SME GM, which uses a relatively low market capitalisation threshold indicating that these markets are mainly focused on micro-caps and illiquid securities. In order to address these issues and increase the attractiveness of SME GMs, the Commission proposed to reduce the administrative burden and cut red-tape faced by SMEs listing shares or bonds on SME GM, by introducing targeted amendments to the Prospectus and MAR regulations as well as technical adjustments to MiFID II.

This proposal was considered to be a first positive step by the panellists but requiring further action for it to sufficiently support the development of SME equity markets in the EU.

A regulator believed that further simplifications need introducing in the field of market abuse. More could have been proposed for example with regard to certain types

of insider lists and manager transactions. More could also be done in the field of prospectuses. An industry representative was favourable to the proposal made in the SME package of a simplified prospectus approach when a company moves from a junior market to a regulated market. This is a process that already exists e.g. in the Nordic region.

The regulator however suggested that more fundamental policy measures would be needed to develop SME markets in addition to the regulatory improvements to MAR and MiFID II proposed in the SME listing package. More structural measures are needed to tackle liquidity issues, promote SMEs as an asset class both to institutional and retail investors, create a more functioning SME ecosystem that may support initial listings and also their ongoing development, as well as provide appropriate incentives.

Another regulator agreed that the impact of simplifying requirements (e.g. a simplified prospectus) can only be partial. More needs to be done on other key points such as reputation, image and liquidity and other tools than regulation are needed for tackling these issues. It is crucial in particular to find the right balance between flexibility and a minimum level of rigour in terms of controls and disclosure obligations in order to ensure investor confidence. For example, market operators and regulators should try to discourage immature projects and very poorly structured companies from listing on public markets.

An industry representative agreed that regulation does not create markets, but facilitates them. While regulation creates a framework, it is the market stakeholders that need to develop collectively the market within this framework. The different channels through which SMEs can be provided with funding (i.e. business angels, family offices, private equity, venture capital, IPOs…) should not be considered as competing with one another, because 'the more, the merrier' and companies should have as many alternatives as possible to finance their growth. One positive 'disruptive' element that can be added is that some IPOs are now handled by crowdfunding platforms which have a MiFID broker licence. This brings the new technology and digital direct access of these new platforms to the client base of more regulated markets.

3.2. Measures to enhance the liquidity of SME equity markets

A regulator mentioned that some measures are proposed in the Commission SME listing package concerning liquidity (creating a common set of rules on liquidity contracts for SME GMs in all Member States in parallel to national rules). Time will tell if these measures are effective, but the fragmentation of liquidity also needs tackling. The quality of liquidity increases if there is concentration around a single trading point. The development of SME GMs seems appropriate in this regard. Creating a single SME market for the whole of Europe is not the right way forward, but further developing regionalised or specialised markets for different types of SMEs should be considered in order to further concentrate liquidity.

Another regulator stated that liquidity is difficult to improve in SME markets, because by definition the companies listed are small and the free float in the market is also limited. Proportionality has been introduced in the rules and requirements concerning these markets in order to provide as much flexibility as possible to facilitate the access of SMEs to public markets, but rigour is also important given the risks involved. Some actions are needed regarding liquidity providers, as proposed in the SME listing package, but the impact may not be significant because the commitments that can be expected from them are limited in practice. Another option could be to impose a minimum free float that could be enforced by regulation or the market. Making sure that the average performance of companies listed on SME markets is sufficient is also important from a reputational point of view. The regulator also remarked that solutions to mitigate downward pressure due to significant fund redemptions exist, such as creating side pockets and suspending redemptions.

An industry representative was against imposing free float requirements for SME listings at the EU level, because defining a minimum level that would work in all markets across the EU is difficult. It should be up to the local market operators to decide what the appropriate level should be. The industry representative also considered that creating pan European SME markets or unifying all existing markets is not the right approach because of the local specificities of each market ecosystem. What is needed is building layers of consistency and harmonisation on top of already existing and developing local markets. This is the approach that has been taken in the Nordic countries where best practices are shared among the seven stock exchanges that operate in the region and which have quite different characteristics in terms of size and maturity. A pan-European market is no substitute for the lack of well-functioning SME markets in each of the EU27 countries.

Another industry representative called for a stronger focus of EU initiatives on the development of cross-border retail investment in the EU. This is currently not happening, particularly because of post-trading barriers that make cross-border transactions very costly and many retail clients prefer to purchase US rather than EU stocks as a consequence. There is a need for an additional retail workstream in the CMU action plan aiming in particular to make post-trade more efficient and less costly within the EU27.

3.3. Maintaining an appropriate balance between retail and institutional investors and re-developing research

Some speakers emphasized the importance of maintaining a combination of retail and institutional investors in SME markets. Retail investors can help to stabilize the market when there are tensions on liquidity, an industry representative stressed. However certain conditions need to be fulfilled for attracting them.

A first condition for developing retail investment in SME stocks is the availability of appropriate research on these securities. The need for the authorities to promote research on SMEs and the development of specialised brokers was advocated by several speakers. Industry-driven initiatives can also be helpful. An industry representative outlined that their organisation, a stock exchange, is running a project with the local institute of financial analysts aiming to offer independent research, free of charge, to 'orphan' companies that are not covered by any research. The institute is responsible for selecting the research staff and ensuring proper governance.

Secondly, MiFID advice and information rules need to be appropriately enforced. Certain intermediaries choose not to provide any advice on certain types of investments in order to avoid incurring any responsibilities, a regulator underlined. Also, rules need to be calibrated so that the access of retail investors is not blocked off. An industry representative whose company owns an online broker however mentioned that they are not allowed to advise their clients on investments. In addition, investors using these platforms prefer to make their own decisions based on independent research that they conduct or are provided with.

3.4. Providing appropriate fiscal incentives

An industry representative stressed that public financial support is crucial for encouraging more listings on public

markets. The best incentive that could be given to the development of SME equity markets would be an equal fiscal treatment of equity and debt. At present there is an asymmetrical situation in most European tax systems, which favours debt over equity due to the deductibility of interest expenses for issuers. This is increasingly hard to justify in a financial system that is inundated with debt and where there is strong support for developing equity financing. Different mechanisms have been proposed to reduce or eliminate this distortion. One of them would be for companies to be able to deduct from their ordinary profits the return on equity, as is the case for interest paid on debt instruments. Another potential fiscal obstacle to the development of SME equity markets is the contradictory situation that is being created by politicians proposing to impose a financial transaction tax while encouraging the development of alternative financing sources to banking.

Another industry speaker emphasized that incentives to encourage investors to invest in SMEs, including fiscal ones, are essential. The Swedish investment savings account, which has now been copied in Norway, Denmark and Finland provides an interesting example of incentives for retail investment. Institutional investors should also be encouraged to invest in SMEs, for example by way of local requirements for a proportion of pension capital to be invested in SMEs.

3.5. A public policy initiative to develop IPOs

An industry representative emphasized the need for a public policy initiative aiming to improve the IPO market structure. Some of the building blocks needed for redeveloping the EU IPO market are in place. One of the best examples of democratised venture capital is in the EU, the industry representative emphasized. The Juncker plan has indeed successfully allocated up to €350 billion of venture related capital to 700,000 SMEs and the IPO pipeline is considered 'excellent' within the universe of these companies. Not all of these SMEs will be eligible to a potential IPO, but this initiative should help to find 1,000 or so companies that ultimately will be.

The industry representative gave some examples of successful IPO reforms that have been implemented in other jurisdictions. In the US, President Obama signed into law the first iteration of the US JOBS Act in 2012 ('Jumpstart Our Business Startups'), which combined a number of acts and initiatives around capital formation reform. In 2012, a new category of emerging growth companies (EGCs) was created and issuance rules were adapted for these companies. For example, responsible relief is given from certain financial reporting standards and auditor rotation rules, which would otherwise be very expensive for such SMEs. Since, there has been a major upswing in the number of EGC IPOs. Their volume has been multiplied by three to four since 2012 and they were up another 38% in 2018 alone. It is estimated that this increase in IPO volumes has resulted in significant job creations in the US, which was one of the key objectives of the JOBS Act (+1.5 million new jobs). Measures to support the development of IPOs have also been proposed or implemented in Canada, Hong Kong and Australia. Australia for example is contemplating an all-electronic online IPO platform.

4. Developing corporate bond markets

A regulator outlined that the corporate bond market has developed over the last few years but this is partly due to monetary policy and it is uncertain how sustainable this trend can be in a changing market environment. Issues in the corporate bond market are similar to those at play in the SME equity market i.e. liquidity, cross-border access on the investor and issuer sides, retail involvement…

Another regulator stated that liquidity is an issue in the corporate bond market. Some domestic regulators have been encouraging issuers to issue on electronic platforms, but that has not been very successful so far. Having more active liquidity providers would be a useful improvement. The regulation of competing instruments, trading rules and ensuring that there is an appropriate mix of institutional and retail investors are other important elements for the corporate bond market.

An industry representative expressed dismay at the lack of development of retail bond markets. It is much easier for an issuer to issue bonds with a high denomination for the wholesale market only and to stick with that, and therefore there is no incentive to create a retail bond market in the EU. The only retail bond that exists in the Nordic markets however is successful, trading on electronic order books with a market maker. This is therefore an untapped opportunity which needs considering with the upcoming normalisation of interest rates and for which some support is needed for developing the market. Another opportunity to consider is the sustainable bond market which is recent but growing very quickly with the increasing awareness of environmental, social and governance issues. This segment now represents 10% of the total Nordic corporate bond market for example.

A regulator noted that caution is required regarding SME fixed income markets, because many of these securities are risky. A prudent approach would be to reserve these markets for institutional investors, especially regarding initial phases. This has been done, for example, in the Spanish alternative fixed-income market (MARF), which was created with the objective to offer an alternative to bank financing and is evolving satisfactorily. In a second phase it might be opened partially to retail investors.

1. SME Growth Markets (SME GM) are a new category of trading venue that was introduced by MiFID II in January 2018 with the objective to raise the profile and visibility of SME Markets across the EU. In order to qualify as an SME GM, at least 50% of the issuers whose financial instruments are traded on the venue need to be SMEs, defined as companies with an average market capitalisation of less than € 200 million. The listing rules of SME GMs must also satisfy certain quality standards in order to guarantee investor confidence, including appropriate admission documents and periodic financial reporting. SME GMs are subject to the new Prospectus Regulation, which has introduced a reduced disclosure regime (the EU growth prospectus) for SMEs which have no securities admitted to trading on a RM. SME GMs are also subject to the Market Abuse Regulation (MAR), which provides two alleviations for these markets: issuers can disclose inside information on the trading venue's website rather than on their own website and SME GM issuers are exempted from maintaining 'insider lists' on an ongoing basis.

Can existing market infrastructures sufficiently support the CMU?

1. Progress made in the implementation of the CMU and the regulation of market infrastructures

1.1. Progress made in the implementation of the CMU

An official felt there has been good progress on the Capital Markets Union (CMU), but much remains to be done. Most of the legislation related to the CMU is not yet in force, so it

will take time to see whether the industry makes use of the new opportunities. The European integration of financial markets is a step by step process that started many years ago with the Financial Services Action Plan (FSAP) and many different elements of it still need putting together. Infrastructure is a part of it and some components such as TARGET2 and TARGET2 SECURITIES have been provided by the Eurosystem.

The CMU initiative is designed to offer new opportunities for financing the economy, as banks are deleveraging, and also to enhance capital allocation and risk sharing across the Union, the official explained. An industry representative added that financial market infrastructures (FMIs) play a key role in supporting the objective of the CMU to further develop funding capabilities in the EU. There is also an objective in the CMU to further integrate EU financial markets, which has implications for financial market infrastructure, a public representative remarked. Another official stated that the goal of CMU on a macroeconomic level is to be able to absorb macroeconomic shocks from the private sector. To do this, efficient infrastructures are needed because FMIs provide the plumbing of the financial system through which funding resources are channelled to the economy.

1.2. Progress made in the regulation of Financial Market Infrastructures (FMIs)

A public representative stated that since the financial crisis several pieces of legislation aiming at strengthening EU market infrastructure have been adopted. Making infrastructures more resilient was a priority for the EU after the crisis.

A regulator considered that Europe is still in the early stages of the implementation of much of its trading and post-trading legislation. Much has been done by the public and private sectors to implement these new regulations and to roll out TARGET2-Securities (T2S), but in some areas such as the CSD Regulation (CSDR), the process has not reached the final stage of implementation and quite a few market adaptations are still going to happen following the implementation of T2S. These new regulations are changing trading and post trading market structures with greater cross-border consistency and harmonisation. However, there is still a considerable amount to be done. Harmonization work started more than 16 years ago with the Giovannini barriers and is still not finished. An official agreed that a considerable amount of effort has been spent on drafting and adopting these legislations, but it is now very important to ensure that they are implemented consistently throughout the EU.

1.3. New opportunities and challenges related to technology

The opportunities that new technologies offer in the context of securities markets were underlined by several panellists. Technology can notably play a role in increasing efficiency and developing capital market activities on a domestic and cross-border basis.

An industry representative however emphasized that new technologies such as fintech and blockchain cannot help to further harmonize legal rules e.g. applying to post-trade, and that further harmonisation of these rules will be needed to leverage the potential of these new technologies. An official added that with the development of new technologies the European authorities must move faster in adopting new regulations or changing them. It should be possible to build on the existing capital market framework to develop in the future more focused and faster to implement legislation, if needed.

2. Main pending issues regarding the regulation of trading and post trading infrastructures

2.1. Enhancing transparency in the trading area

Concerning the trading layer and the role that it may play in developing more capital market funding and liquidity, an industry representative emphasized that transparency is the starting point. It is at the heart of price discovery and efficient markets and also reduces market abuse, thus raising trust. At this stage however transparency has not yet been fully delivered when considering what has been achieved with MiFID II in particular and some issues still need addressing.

Another issue, the industry representative stressed is that beyond the necessary consistency in the implementation of rules across jurisdictions, there also needs to be consistency across regulatory dossiers impacting trading activities. In particular, how liquidity is provided in markets is very important. For example, the market making requirements in MiFID are not appropriately reflected in the investment firm review and this may impede liquidity. Taking a step back to check that the different rules applying to a given area are consistent and fit together is important for achieving the CMU.

2.2. The need for a further harmonisation of post-trading rules

An industry representative stressed that safety and financial stability are improving in the post-trading area, with the on-going implementation of the new EU regulatory framework for FMIs. The second objective which is to further harmonise rules and processes is 60 to 70% completed. This is a key objective in the CMU context because insufficient harmonisation increases costs for issuers and investors. The European Post-Trade Forum (EPTF) is continuing and completing the work initiated with the Giovannini barriers in this regard, but it is unfortunate that the EPTF published its report before CSDR and T2S were fully implemented, because these new initiatives may generate new barriers. In addition, the EPTF recommendations still need implementing.

A key question that remains to be tackled, the industry speaker felt, is whether increasing consolidation and competition in the post-trading space is still an objective of the EU and what the appropriate level of consolidation to support the CMU may be. CSDs in particular are a business based on economies of scale, but with 30+ CSDs in the EU27 it will be difficult to reap all the potential benefits of economies of scale, despite the improvements provided by the CSDR and TARGET2-Securities (T2S). These initiatives should normally facilitate the consolidation of CSDs in the EU and the development of competition between them, but the lack of harmonisation of securities law and of tax procedures is blocking these evolutions. Although post-trading processing costs are only a small part of the total cost of cross-border securities transactions, the speaker believed that legal and fiscal harmonisation objectives should be reconsidered notably in the context of the EPTF, because this would facilitate cross-border securities transactions in the EU. The question is whether there is a political will to go beyond the national interests of Member States and their local CSDs.

An official observed that with the CMU there is also a question of whether the EU has sufficient capital markets for the size of its existing infrastructure. The answer is probably no. The goal is therefore to increase the size and liquidity of markets in order to diversify the sources of funding for companies and savers.

Another official considered that in the context of the digital economy, it is important to consider whether

these fragmented infrastructures are able to survive because in other areas of the industry fragmentation e.g. of payment systems does not work on a sizeable and harmonized platform such as Amazon. This could also be an opportunity to reconsider the concept of the '29th regime' in the area of market infrastructures in order to overcome the fragmentation of the legal environment.

2.3. Strengthening the third-country regimes of EU market regulations

A regulator emphasized that a sound regime is needed for third-country market infrastructures wishing to access the EU market. EMIR 2.2 (the review of requirements for the supervision of EU and third-country CCPs) is the most important priority. With Brexit, it is essential to finalise this proposal as quickly as possible. The Parliament has adopted its report, so it is mainly now a task for the Council. There must be a regime in place to deal with Brexit in the CCP space in a timely way and this will also apply to other third-country CCPs.

An official stressed that a broadening of the third country regimes applying to market infrastructures is needed. For example, in CSDR there is a recognition regime for third country CSDs but it only applies to notary and central maintenance services. There are no third-country rules for settlement services for example, which means that third country CSDs can provide these services freely with no level playing field whatsoever. Similarly, the inconsistency of MiFID third country regimes for trading venues is also an issue. Those are problems which are important to tackle in the perspective of Brexit, following which a substantial part of the market infrastructure servicing the EU27 market will be outside its borders.

An industry representative explained that the third country regimes of EU legislations should provide a healthy balance between access to markets and preserving prerogatives in terms of financial stability. These regimes need improving, however they are split across many regulations. In addition to CSDR and MiFID, there are missing parts regarding third-country access rules in AIFMD and UCITS in particular. Brexit requires these changes to be made, but they are also necessary for managing relations with other third countries such as the US and Japan.

A public representative believed that the problems mentioned are consequences of a 'horizontal' policy area (i.e. third-country access) being addressed using 'vertical' regulations. The concept of a review clause could potentially be used to address some of these problems. Another issue is that third-country regimes were conceived for jurisdictions that do not have the level of business with the EU that the UK has in the financial sector and that it appears to want to maintain.

3. Improving supervisory convergence at the EU level

A regulator emphasized that improving supervisory convergence, as proposed in the context of the review of the European Supervisory Authorities (ESAs) is essential in the market infrastructure space where consistency in the implementation of rules needs improving. EMIR and the discussions around EMIR 2.2 have demonstrated that the collective supervisory effort made in the context of CCP colleges is achieving positive results, but stronger coordination is needed because colleges sometimes take different approaches. It is clear that moving to a single European supervisor for all European financial markets will not be possible in the short-term. However, it is necessary to consider where greater coordination makes sense. An area where this is particularly the case is the interaction with third country market infrastructures where providing a single point of contact and real consistency in how to access the European market is essential.

An official emphasised that the single rulebook must be applied in a consistent way. Before discussing a single supervisor, it is necessary to discuss a single way of supervising and interpreting rules, which is the main role of the ESAs. In the ESA review, there was much debate about direct supervision, but the most important objective is to achieve further convergence in supervisory practices. Whether there should be a unique supervisor for the EU or one for each Member State is secondary. This having been said, market infrastructures are probably the type of financial institution that is by nature the most cross-border. The type of central supervision that has been put in place for systemic Eurozone banks with the SSM would make even more sense for market infrastructures at the EU level. However, the debate about EMIR 2.2 demonstrates that this is a contentious subject. It is desirable to move towards single supervision in the long-term, the official believed, but this must be done progressively. In any case, it is not institutional changes but attracting more business to Europe that will help to develop capital markets and achieve CMU objectives and that will ultimately give rise to needs for more unified supervision.

An official acknowledged that the SSM is a success. The interactions between the National Competent Authorities (NCAs) and the Supervisory Board of the SSM are fruitful and help to improve supervisory decisions. Although this has made supervisory processes more complicated and lengthy, the outcome is better than it was before. What the SSM experience also shows, the official emphasized, is that it is possible to centralise supervision without unifying the market. The structure of banks in Germany, for example, is completely different from France. The SSM experience shows that it should be possible to move towards a more centralised supervision of market infrastructures, while respecting national specificities, different market functions and different business models.

4. Possible implications of a no-deal Brexit for EU market infrastructures

4.1. Challenges raised by Brexit for the completion of the CMU

A regulator suggested that Brexit is an accelerating factor for the completion of the CMU. The EU27 needs to ensure in particular that it has the necessary market infrastructure in place that it is sufficiently safe and efficient and able to deliver the level of transparency required.

In the perspective of Brexit, a key question to address is whether there is the need for a globally relevant financial centre in the EU27, an official stressed. The EU will be losing with the UK its only significant financial market at the global level. No other market in the EU has the size, liquidity or variety of products that are available in London or New York. However, the EU has the potential with the totality of companies, investors and professionals present across the continent and the corresponding liquidity to create a market that can compete on the global scale. This can potentially be achieved by integrating existing financial marketplaces in the EU into a network linked up by digital means. This is an objective that the EU should strive for beyond the CMU.

4.2. Short-term challenges raised by a possible hard Brexit

An official advised the industry to hope for the best and prepare for the worst. Preparedness is very important for the industry and for public authorities. In addition, there

will be a cost to Brexit in any case and these costs might be higher in a no deal scenario. If there is a very hard Brexit, setting the right priorities for the EU will be essential and in particular any issue that could trigger financial stability risks will have to be addressed. Clearing is the area with the highest financial stability risk and for which solutions need to be found. A regulator considered that implementing EMIR 2.2 is therefore the most important priority in the short-term because CCPs will be a central element in the management of a possible hard Brexit.

An industry representative stressed that there would be short and medium term effects of a hard-Brexit on the whole of the value chain. Preparing for this at the industry level involves different assessments and actions. First, market infrastructures must assess with their members the possible impact of Brexit on market liquidity, which is important for orderly price discovery, and also the readiness of end-clients, in order to identify possible legal or technical measures that may be needed to mitigate any negative impacts or uncertainties. Since at present, more than 50% of the EU's liquidity in the trading space comes from the UK for equities and derivatives, it is essential to avoid a sudden change. Secondly EU based FMIs are in contact with the UK authorities to discuss their future status in the UK. Lastly, some FMIs are developing new services for example for the clearing of euro-denominated interest rate swaps that are relevant in this context.

Another industry speaker described the difficult situation that certain UK-based FMIs servicing EU clients are facing with Brexit. A hard Brexit raises the question of how to ensure continuity of service. For CSDs this notably involves checking the CSDR provisions on grandfathering and third country recognition.

An official did not believe that the dependence of EU counterparties on UK infrastructure would last in the longer term, irrespective of the Brexit scenario. Ultimately market participants will need to adapt to the changing environment and the regulatory landscape. Although market participants need to prepare for changes in the short-term, these changes should mainly be transitional.