[Responses submitted via online questionnaire]

Priorities for early action

1. Beyond the five priority areas identified for short term action, what other areas should be prioritised?

IFIA agrees with the priority areas identified for short term action and wishes to comment on the following areas as important considerations in building a durable and effective Capital Markets Union (CMU):

- Avoidance of unnecessary regulatory and administrative burdens
- Ensuring consistency and a level playing field
- Ensuring policy initiatives are aligned across EU institutions
- Open architecture and a global framework
- Reporting harmonisation and the need to focus on efficiencies

<u>Avoidance of unnecessary regulatory and administrative burdens</u>

Since the financial crisis of 2007/2008, there has been a substantial level of new financial services legislation at EU level. The IFIA therefore welcomes the fact that the current EU Commission intends to focus its resources on (a) reviewing the effectiveness of recent EU financial legislation and (b) producing fewer new legislative proposals (with the new legislative proposals focusing on a number of key priorities such as enhancing the effectiveness of the CMU).

Striking the right balance in terms of any regulation arising out of CMU will be critical. Any review of financial services legislation should include an evaluation of the appropriateness and effectiveness of the legislation, including whether it is achieving its goals in a proportionate manner. Regulatory initiatives envisaged under CMU should undergo a thorough economic impact assessment and a thorough check for consistency with each other.

We welcome the goal under CMU to encourage further the establishment of cross-border funds and to reduce set-up costs associated with these funds and have made some specific proposals in this regard in response to Question 11.

<u>Ensuring consistency and a level playing field</u>

All regulatory initiatives envisaged under CMU should undergo a thorough economic impact assessment and a thorough check for consistency with each other. In particular, we would encourage a review and cost-benefit analysis of certain requirements associated with the establishment of investment funds and management companies under the UCITS and AIFM Directives. We would also encourage a review of all existing and relevant policy and regulatory initiatives within the European Commission and across the various European Supervisory Authorities and the ESRB to ensure they are consistent with the objectives of CMU.

In addition to ensuring that there is consistent regulation across all relevant sectors, it is also important to ensure that overlap and inconsistencies between regulatory regimes are kept to a minimum.

To take one example, certain entities (such as closed-ended funds and certain REITs) can be subject to both the Prospectus Directive and the AIFMD when making an offer of shares/units. There is considerable (and at times contradictory and unhelpful) overlap between the Prospectus Directive and AIFMD. Such entities fall under the Prospectus Directive insofar as their activities relate to the offering of securities throughout the EU. Offers of securities in such entities also come within scope of AIFMD if they fall within the definition of an AIF and have an authorised AIFM insofar as their activities relates to the marketing of units or shares of AIFs in the EU.

We would suggest that f an entity (be it a REIT or a closed-ended fund) has complied with the terms of the Prospectus Directive in respect of the offering of securities, then it should not also be subject to separate marketing or public offer rules under the AIFMD or under local national legislation relating to offers to retail investors, as that would run contrary to the harmonisation of public offer rules that the Prospectus Directive sets out to achieve and is inconsistent with the objectives of CMU.

Ensuring policy initiatives are aligned across EU institutions

We would suggest that there is an apparent divergence between the Commission's objective to increase market-based finance and a number of regulatory initiatives currently underway both within the European Commission and across the EU institutions. We would encourage the Commission to work with other EU institutions to resolve any mismatches in approach that could risk undermining the objectives of the CMU. In this regard, we would highlight:

- The proposed Money Market Fund Regulation
- The proposal for a Financial Transaction Tax which would act as a deterrent to investing in capital markets
- MiFID II rules on pre- and post-trade transparency for fixed-income which could inhibit new issuance and/or reduce secondary market activity
- The recently published EBA consultation on shadow banking guidelines for entities falling outside of a regulated framework

Despite being targeted at unregulated entities, the draft EBA guidelines propose to bring all types of AIFs and all money markets funds within scope of onerous prudential requirements, notwithstanding the fact that such funds are subject the detailed requirements of either the UCITS or the AIFM Directives. Money market funds, whether structured as UCITS or AIFs, will additionally be subject to the new Money Market Fund Regulation. We would suggest that there is a persistent view to regulate investment funds undertaking portfolio management as if they were banks – this approach does not align with CMU and we would suggest that it needs to be addressed.

Open architecture and a global framework

The IFIA very much welcomes the recognition in the Green Paper that capital markets must be open and globally competitive and designed to take into account the wider global context and framework. CMU will simply not function effectively unless the EU framework is interoperable with other jurisdictions,

given the interrelated nature of capital markets. Several EU regulatory frameworks, such as AIFMD, EMIR and MiFID II, require cooperation arrangements and equivalence assessments with other jurisdictions. We would emphasise the need for a proportionate assessment process, which takes into account the need to recognise differing requirements which can achieve the same effect.

We would highlight ESMA's consultation on asset segregation guidelines under AIFMD as a recent example. Industry highlighted the need for a more market-specific approach to asset segregation in recognition of local legal, regulatory and operational arrangements. We welcome efforts under CMU to bring about greater insolvency harmonisation in that regard.

We also support initiatives to strengthen the global regulatory framework such as IOSCO's consultations on the custody of collective investment scheme assets and on cross-border regulation. In particular, the challenges arising from diverging global rules in the area of insolvency protection and asset segregation are encountered by Irish depositaries overseeing the investments of cross-border funds invested globally. IFIA would welcome a global initiative to ensure effective legal recognition of the segregation of a fund's client assets from the proprietary assets of the relevant fund's depositary.

Reporting harmonisation and the need to focus on efficiencies

As each new EU regulation is released, additional reporting or data requirements are imposed either directly or indirectly on asset managers and/or service providers, such as under AIFMD, UCITS IV, EMIR, the EU Money Market Fund Regulation, MiFID II, Solvency II etc. The cost of complying with such requirements is extremely high for firms and while many of the bigger asset managers and service providers have, in some cases, been able to absorb the cost due to their scale, these obligations can be particularly prohibitive for smaller players and new start-ups and are contrary to the innovation that CMU seeks to promote. Where costs cannot be absorbed they will ultimately reduce shareholder returns.

While we do appreciate and understand the reason for and reliance placed on data by supervisory authorities across the EU, we would advocate strongly for more of a consistent and strategic approach to these requirements. An integrated reporting strategy would improve market efficiencies, reduce costs and avoid duplication and overlap. CMU presents the opportunity to develop the integrated approach to reporting. A starting point would be a comprehensive review and analysis of all data and reporting requirements at European and national level, what is required, by which authorities, for what purpose and whether data received to date is fit for purpose. This analysis should also identify where synergies can be achieved and duplication avoided. Consistent with a global approach, the analysis should consider the data and reporting requirements from authorities outside the EU for example Form PF under Dodd Frank in the USA.

Currently each national regulator has to develop its own reporting platform/system all of which are different and vary in terms of sophistication. We suggest a Common European Reporting Platform controlled by ESMA to which all stakeholders submit their data and from which all regulators can obtain the information necessary for supervision. A central point of data collection/reporting would ensure consistency and quality of information is controlled.

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

We believe that the implementation of a centralised EU-wide database containing standardised credit information on participating SMEs would facilitate greater investment in the SME sector on a cross-border basis. In order to ensure that SMEs are not deterred by the complexity and administrative burden involved, the key data required should be kept to a minimum and both the investor and the SME sectors should be consulted on the type of data that would be practical to include. Appropriate technical standards should then be developed accordingly. In keeping with reducing complexity and red tape for SMEs, there should be standardisation of the information that needs to be disclosed to both investors and regulators.

It should also be noted that the term "SME" refers to a very diverse group of business in terms of scale, activities, growth potential and financing needs. The smallest SMEs, which make up a large proportion of the economy in many Member States, will be unlikely to seek funding from the public markets in comparison with mid-sized companies and will constitute a much smaller investment proposition. However, many small and high growth companies would benefit from capital injections and would appeal to private equity and venture capital investors for example, thereby freeing up bank balance sheets. In order to match investment needs and investor specialisations and preferences, any EU credit information database needs to segment SMEs by characteristics such as scale, sector etc. Special initiatives for smaller SMEs to access funding warrant consideration. This includes reducing administrative hurdles and costs associated with debt issuance.

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

<u>Investment by UCITS and other retail products</u>

ELTIFs will be open to retail investors and it is important that they will be complementary to UCITS as the predominant pan-European retail fund product. With assets of almost €8 trillion, UCITS can provide significant investment potential for ELTIFs. There should also be scope for investment in ELTIFs by other retail investment products. Consideration should be given to the level at which investment by UCITS and other retail investment products in ELTIFs should be permissible with regard to the overall liquidity profile of these investment products. Allowing ELTIFs to be included within the current 10% limit for unapproved securities within the UCITS Directive could be a significant source of funding for ELTIFs and should not endanger a UCITS' liquidity profile. ELTIFs could be particularly valuable for inclusion in long term multi-asset solutions.

<u>Tackle regulatory, accounting and tax barriers to investing</u>

It is important to ensure that key target investor groups for ELTIFs are not subject to unfavourable regulatory, accounting or capital treatment which would prohibit their investment. Rules relating to capital requirements under Solvency II, CRD, IORP as well as EIOPA's assessments need to be reviewed and recalibrated such that they do not discourage insurers, pension funds and other institutions from investing.

Treatment of professional and semi-professional investors

ELTIFs will be treated as complex products under MiFID and regulators may raise substantial investor protection concerns about the availability of such complex products to retail investors. IFIA therefore welcomes the flexibility afforded under the ELTIF Regulation to market ELTIFs solely to professional investors. However, this could limit the availability of ELTIFs to semi-professional type investors such as smaller pension funds, municipalities, foundations and charities. Such investors have profiles which fit with the long term investment strategy of ELTIFs. Under the ELTIF Regulation, these types of investors can request to be treated as professional subject to meeting the requirements of Annex II of MiFID. However, conditions under MiFID, such as a minimum frequency of ten trades per quarter, are not easily met by these investor groups. We therefore recommend that the criteria applicable under the ELTIF Regulation to mid-scale investors be reviewed in order to facilitate investment by this important category of investors. We would encourage the Commission to determine more appropriate investor criteria aligned with those foreseen under the EuSEF/EuVECA Regulations for semi-professional investors.

Ability to invest in loans

ELTIFs are clearly permitted under Article 9(c) of the ELTIF Regulation to originate loans to eligible undertakings. The ability to buy or invest in loans on the secondary market is less clear. Since ELTIFs can originate their own loans, there is no reason why ELTIFs should not be permitted to invest in other high quality loans. The flexibility to invest in as well as originate loans forms a core part of the strategy of investment managers specialising in this area. We therefore encourage a clarification by ESMA that investment in loans is permitted under the eligible investment rules for ELTIFs.

Aligning the redemption rights policy and the lifecycle of ELTIFs

The ELTIF Regulation allows the manager an appropriate level of flexibility to devise a redemption policy that fits with the investment strategy and the underlying asset profile. The same flexibility should be afforded in relation to aligning redemptions and the choice of the lifetime of the ELTIF. ELTIFs must be established for a predetermined and finite period but the manger needs to have scope to extend the lifetime to align with market conditions, acting in the best interests of investors. ELTIFs managers should not be forced to sell assets under unfavourable market conditions where potential contract partners would be aware of the situation and could use this for their negotiations. ESMA should therefore clarify the definition of "sufficient in length lifetime" that would allow managers scope to extend the lifetime of the ELTIF while acting in the best interests of investors.

Development of a secondary market for ELTIFs

The development of a liquid secondary market for ELTIFs would strongly support the take-up of the ELTIF and Article 19 of the ELTIF Regulation clearly provides for secondary market trading of ELTIF shares. However, concerns have been expressed that trading in secondary markets may work in some markets but in others market makers would request high premiums to provide liquidity to ELTIFs or that the ELTIFs units will be traded at a significant discount which would significantly hamper the development of the secondary market. The European Commission should consider if there are additional measures that could be taken to promote and support the development of the secondary market.

Exemption from the Prospectus Directive

ELTIFs should be exempted from the obligation to issue a prospectus under the Prospectus Directive as this would constitute an additional layer of disclosures without adding value to the existing and extensive disclosure requirements under the AIFMD as well as under the "Key Information Document" (KID) to be provided as part of the Packaged Retail and Insurance-based Investment Products" initiative (PRIIPS). It should be further assessed what is the right level of disclosures in the case of listed ELTIFs. We also recommend that EIOPA's current analysis of the capital weightings for infrastructure investment by insurance companies under Solvency II should be calibrated so as to provide an incentive to invest in infrastructure by recognising the benefits of diversification that an ELTIF could bring.

PRIIPs

Article 23(1) states that the units or shares of an ELTIF shall not be marketed to retail investors in the Union without prior publication of a key information document in accordance with Regulation (EU) No 1286/2014. The KID will be a three page document that will set out in plain language what are the most important features of the PRIIP and what are its main risks. The European Commission should consider whether further clarification is required on the nature of the information to be included in the KID for ELTIFs given the specific nature of the product and related risks.

Harmonised implementation

The ELTIF is to be adopted as an EU Regulation to avoid any gold-plating which would cause distortions of competition and undermine investor confidence in the product. Through the authorisation and supervisory processes and procedures it is essential and required directly by EU legislation that all Member States conform with the ELTIF legislation without imposing any additional conditions. To ensure investor confidence in the product it is essential that this approach is respected. In circumstances where there are concerns regarding the framework, this should be referred to the EU level for further consideration and agreement rather than being addressed at a national level. As part of the review provided for under Article 38 of the ELTIF Regulation it may be appropriate for the European Commission or ESMA to undertake a review of the implementation of ELTIF to ensure all Member States are implementing the Regulation in a harmonised manner and that clarification of the requirements is provided where inconsistent practice across Member States emerges.

Loan origination by investment funds, which is a permitted activity within the ELTIF, should be subject to the same framework across Member States as otherwise this will result in an uneven playing field which will ultimately damage investor confidence in the broader ELTIF product.

Given the interconnectedness of the ELTIF Regulation and AIFMD, and the EuSEF and EuVECA Regulations, it may be appropriate that the review of the ELTIFs Regulation takes place at the same time or immediately after the review of the AIFMD, which is foreseen for 2017.

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

Measures to develop and integrate capital markets

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

Developing an appropriate framework for loan origination funds

In a report on "Trends, Risk and Vulnerabilities" (No. 1 2015), ESMA highlighted loan origination as a focus area. The report highlights the recent and rapid growth in both loan participation and loan origination funds and noted that "this fledgling activity should develop within a harmonised EU framework that has appropriate risk mitigants in place". IFIA welcomes the prospect of an EU harmonisation initiative to ensure an appropriate level of regulation of loan origination across the EU in order to effectively mitigate risk and also to ensure a level playing field between Member States. However, we would also caution against the systemic risk oversight or supervisory authorities imposing constraints that would stifle this growing activity, as this would go against the policy objectives of CMU. It is important to strike an appropriate balance when regulating loan origination, as has been borne out in the Irish experience.

Addressing barriers to lending

In addition to the development of an appropriate regulatory framework for loan origination, local barriers to deploying these funds for lending need to be removed. Otherwise, we will be left with a situation where capital can be raised cross border, but in practice, not deployed cross-border. Some barriers that will need to be addressed at a European level to provide a level playing field between bank and non-bank (such as loan origination funds) lenders include:

- Removal of the legislative preference given to banks in bankruptcy proceedings - equal treatment of bank loans and bonds in bankruptcies
- Standardisation of procedures for taking security, enforcement and for creating loans/bonds, in particular equivalent standards for European company registers for registering and enforcing pledges and similar charges
- Remove barriers to lending (as distinct from deposit taking) such as the need for banking licenses etc. by allowing other regulated institutional investors or vehicles to lend
- Additional initiatives to align tax incentives at national level such as: a) the removal of withholding and of transaction taxes on lending/interest, at least within the EU and b) the legislative preference given to banks, for example in taking security (stamp duties etc.) and transaction taxes.

We would suggest that a key focus of the CMU is to look at how to surmount these barriers. Some of our members have suggested the creation of an 'asset passport' that would give qualified funds (certain AIFs or ELTIFs) the right to deploy capital cross-border on an equal footing with banks. This would, in effect,

address some of these barriers in a product-specific way, rather than going down the long and politically-challenging path of harmonising all of the relevant legal frameworks across all of Europe.

More generally in terms of channelling funds we believe that developing diverse sources of funding for European companies to complement existing bank financing will be key. In this sense it is important to ensure that European capital markets work as efficiently as possible to support the varied financing needs of European companies. In this respect there are some core focus areas:

- Ensuring that Level 2 rules in MiFID are appropriately calibrated especially regarding liquidity in debt markets. A dynamic secondary market is essential to support the continued growth of pooled funds. The development of ETFs would be further supported by the delivery of the European consolidated tape allowing individual pools of liquidity in different national markets to be seamlessly linked
- While diversification of funding sources is a benefit the full potential of capital markets union will fail to be met without a concerted effort to educate SMEs on how to access the greater range of funding options available to them.

Money market funds as an important investment channel for SME finance

In the context of proposals on the Money Market Fund Regulation (MMFR), European policymakers should seek to find a workable outcome for companies that will need reliable cash management tools. Part of this is preserving the specific characteristics that make money market funds (MMFs) most useful to their users – operational ease, intra-day liquidity, and workable accounting and tax treatment. This means preserving a constant net asset value (CNAV) MMF product under the MMFR in order to avoid decimating the MMF industry. The elimination of a viable CNAV option for MMFs will have a very damaging impact on the success of CMU due to the removal of CNAV funding for European businesses.

While there has been considerable political focus on reviving term securitisation markets in Europe, there has been comparatively little focus on the role that Asset-Backed Commercial Paper (ABCP) plays in funding European companies. ABCP is considered short-term securitisation by some of the policymaking bodies. However, a more accurate comparison for a 'fully-supported' ABCP programme (as almost all in Europe are) would be a short-term covered bond. ABCP is a key funding tool for many SMEs – the underlying assets in the pool generally comprise of commercial and consumer receivables, equipment leases and loans – but the MMFR risks cutting off a critical investor base for ABCP. If the final regulation unduly restricts MMFs ability to invest in ABCP, a key funding source to European companies could be greatly impaired. The Commission proposal contains unnecessary restrictions on the types of assets that can be put into collateral pools (only corporate debt – where nearly all European ABCP programmes contain both corporate and consumer debt), on the maturity of the underlying assets (restricted to 397 days, where many of the programmes contain debt with a maturity up to 5 years), and also a 10% cap on the total of a portfolio that can be invested in ABCP (as opposed to be treated as exposure to a particular counterparty, as any other corporate paper would be).

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

We welcome the focus on liquidity and standardisation in the bond markets and support comments made by the European Fund and Asset Management Association (EFAMA) in that regard. Specific measures to enhance liquidity and promote standardisation include:

- Review of the appropriateness of the MiFID/MiFIR liquidity thresholds for non-equity instruments currently being considered
- The creation of more bond trading platforms and related trading protocols
- Improve the investment chain by focussing on intermediaries, infrastructures and the broader legal framework
- An overall reduction of the number of bonds in issuance to stimulate liquidity
- Registration of bonds at the relevant National Competent Authority (NCA) prior to their issuances on the markets
- Standardisation of coupon dates that would facilitate processing
- Standardised bonds could also be listed on an official trading venue which would help reaching a higher level of electronic trading (which in turn would improve price transparency)

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

<u>ESG investment</u>

IFIA supports the EFAMA position that no legislative action by the EU is needed in relation to the development of ESG investment because these considerations are already addressed through EU measures which have increased transparency and disclosures from issuers. The European Commission could also support and promote private sector initiatives on corporate social responsibility (CSR) codes of conducts. It should be noted that Responsible Investing (RI) or ESG is a means to an end rather than the end itself and CSR policies should be used to induce corporations to change their behaviour on areas where legislation is inappropriate or insufficient. Continuation of a policy of enhanced disclosures combined with the promotion of adherence to CSR codes will enable asset managers to increase ESG investment.

<u>Green bonds</u>

We would draw the Commission's attention to the existing industry work on promoting common standards for Green Bonds such as the International Capital Markets Association's (ICMA) Principles on Green Bonds and the Ceres "Statement of Investor Expectations for Green Bonds". Developing a consistent regulatory framework in Europe for Green Bonds will require cooperation between issuers, investors and regulatory bodies. Agreement on a common definition of a Green Bond is key, including common characteristics which can form the basis of future regulatory treatment. As such, we believe that the EU can build on existing industry work to develop greater clarity of standards and procedures for Green Bonds. In particular, the European Commission could support efforts towards uniform

templates for environmental reporting which could also provide a benchmark against which other climate friendly investments could be measured. As well as delivering standardised comparable metrics, this could provide regulatory benefits for both issuers and investors. A clear European definition could also spur greater participation by national development banks and at European level by the EIB and EFSI.

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

Getting the right financial information for the credit assessment and review process from SMEs is currently an issue (even for banks). The inconsistencies in the financial reporting frameworks used for SME reporting across the EU is one of the reasons for the differences between the markets in the US and the EU.

Having a consistent financial reporting framework for SMEs across the EU would significantly improve transparency and comparability. In this regard, "IFRS for SMEs" is a widely adopted accounting framework for SME financial reporting. The "IFRS for SMEs" is a self-contained Standard of 230 pages, designed to meet the needs and capabilities of small and medium-sized entities (SMEs), which are estimated to account for over 95 per cent of all companies around the world.

Compared with full IFRSs (and many national GAAPs), the IFRS for SMEs is less complex in a number of ways:

- Topics not relevant for SMEs are omitted. Examples: earnings per share, interim financial reporting and segment reporting.
- Where full IFRSs allow accounting policy choices, the IFRS for SMEs allows only the easier option. Examples: no option to revalue property, equipment, or intangibles; and requiring a cost model for investment property unless fair value is readily available without undue cost or effort.
- Many principles for recognising and measuring assets, liabilities, income and expenses in full IFRSs are simplified. For example, amortise goodwill; expense all borrowing and R&D costs; cost model for associates and jointly-controlled entities; and no available-for-sale or held-to-maturity classes of financial assets.
- Significantly fewer disclosures are required (roughly a 90 per cent reduction).
- The Standard has been written in clear, easily translatable language.
- To further reduce the burden for SMEs, revisions to the IFRS are expected to be limited to once every three years.

The Standard is available for any jurisdiction to adopt, whether or not it has adopted full IFRSs. The IASB's only restriction is that listed companies and financial institutions should not use it. As such IFRS for SMEs would not be available for companies listed on MTFs. In such cases full IFRS would need to be applied.

Full IFRS and IFRS for SMEs are already being adopted by many entities, both within the EU and outside the EU. Adopting such a globally adopted and accepted set of accounting standards would ensure

consistency and comparability for SMEs across member states of the EU but also between SMEs based in the EU with similar non-EU based entities.

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

Crowdfunding is a growing source of alternative finance and has the potential to play an important role as a complement to traditional sources of financing, particularly for start-up companies and growing businesses. Indeed, in some jurisdictions crowdfunding is in the process of realising this potential.

Crowdfunding business models generally involve a platform that acts as a meeting point through which fund seekers advertise their projects to potential fund providers. If a crowdfunding platform is used, then crowdfunding transactions involve three categories of participants, namely fund seekers (including SMEs), platform operators and fund providers (investors). Those providing funds may do so as a donation or reward. They may also provide funds through a loan or through investments such as the purchase of a debt, equity or other security. These latter types of loan and investment based crowdfunding are of particular relevance to SMEs.

Unregulated crowdfunding presents a number of risks for each category of participant, as the European Banking Authority (EBA) outlined in a recent Opinion (EBA/OP/2015/03). According to that Opinion, risks to investors include counterparty or credit risks; risks arising from lack of transparency or misleading information; legal risks, operational risks and risks arising from fraud. More specifically, in an Irish context, it is worth noting that in June 2014, the Central Bank published a Consumer Notice on Crowdfunding, alerting consumers to the fact that it is not currently a regulated activity in Ireland and to the existence of specific risks associated with crowdfunding investments.

As is clear from the EBA's Opinion, the investor protection issues posed by crowdfunding are similar to those which arise in other areas, including in particular asset managers who engage in loan origination. This underscores the need to establish a balanced regulatory framework for crowdfunding which ensures that crowdfunding investors are effectively protected and the existence of a level playing field between crowdfunding and other types of investment opportunities.

Generally, appropriate regulation of crowdfunding, whether at national or EU level, should take into account a number of considerations. Specifically some models of crowdfunding may already fall under the scope of existing legislation and the regulators should clarify the applicability of this legislation to crowdfunding. The need for such clarification is supported by both the European Securities and Markets Authority (ESMA) and the EBA. Relevant existing legislation may include, for example, the Markets in Financial Instruments Directive, the Alternative Investment Fund Managers Directive, the Prospectus Directive and the Payment Services Directive.

Once the scope of application of the existing legislation is clarified, regulators should review that legislation to ensure that it provides investors with a level of protection which is at least equivalent to that provided in investment management, while also taking into account any specific risks posed by crowdfunding. For example, the current review of the Prospectus Directive should take into account the potential impact of that Directive on crowdfunding.

In addition, the new regulatory framework should be proportionate and avoid a "one-size fits all" approach. There are a number of different crowdfunding models and within those models themselves crowdfunding participants, including in particular crowdfunding platforms, are likely to have different characteristics. Investor protection issues may differ depending on the crowdfunding model used.

Furthermore, given the fast evolving nature of the crowdfunding landscape, the new regulatory framework will need inbuilt flexibilities so that it continues to ensure adequate investor protection in the face of technological development. It will clearly be a challenge to devise a regulatory framework which is sufficiently flexible from a developmental perspective while simultaneously providing the necessary level of harmonisation to promote trust and confidence in crowdfunding and prevent regulatory arbitrage.

Developing and diversifying the supply of funding

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

Institutional investors such as insurers and pension funds should have appropriate incentives to invest more of their portfolio in less-liquid asset classes which can assist them to meet their long term liabilities. In line with EFAMA's position, a number of policy measures need to be considered:

<u>Prudential frameworks</u>

Currently, risk-weighting calibrations in Solvency II and CRD make many long term investments such as those into infrastructure investments or supporting long term SME investment far less attractive because of the capital charges associated with them.

<u>Infrastructure projects</u>

- Facilitate the development of stable and predictable regulatory environments
- Enhance the role of ELTIFs and certain types of AIFs as investment vehicles to encourage the development of both private institutional investment and public investment through the European Investment Bank and EFSI
- Develop a predictable pipeline of investment meeting a clear set of criteria agreed between investors and policy makers. This will encourage a wider range of institutional investors to commit internal resources to identify and invest in viable investment opportunities
- Building up a pipeline will also address the lack of viable investment opportunities and thereby minimising the risk of public sector investment crowding out private sector funding

SMEs financing

- Provision of high quality credit information data shared on equal basis with banks and investment funds
- Financial education of SMEs to take into consideration all available options, i.e. both debt and equity financing

Tax incentives

Member states could incentivise institutional investors to raise larger amounts of funds through tax benefits that can stimulate citizens to save into long-term/retirement savings products.

Access to data

Centralised information about project pipelines is necessary. For SMEs, availability of credit information is essential to increase funding opportunities, mostly only accessible to banks therefore justifying their historical dominance as primary lenders to most SMEs. Ensuring that more SMEs, especially larger ones, are turning to public markets for funding (either debt or equity) would increase the investor base and in turn free up more capital from banks to lend to other companies that are smaller in size and hence less able to access markets.

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

We welcome the goal under CMU to encourage further the establishment of cross-border funds and to reduce set-up costs associated with these funds.

Review of management company requirements

We would welcome an EU review and cost-benefit analysis of the requirements associated with the establishment of investment funds and management companies under the UCITS and AIFM Directives. The level of requirements imposed in recent years on management companies have been significant and can work against a cross-border management model in which delegation is prevalent and more in favour of a domestic type industry. We would highlight various organisational and operational requirements as well as AIFMD's rules relating to delegation. These rules can detract from fund managers setting up and marketing UCITS and AIFs on a cross-border basis and should be reviewed on a cost benefit basis to ensure that they are proportionate. We have set out some further examples below of requirements that should be amended and would be happy to engage separately on this initiative.

Master-feeder arrangements under UCITS IV

UCITS IV sought to increase efficiencies in the European fund market through greater rationalisation and the generation of economies of scale. One tool to achieve this was the provision for master-feeder structures under the UCITS framework. However, the application of a "10% rule" prevents UCITS which invest more than 10% in another fund from investing in a feeder fund. This discourages managers from setting up feeder fund structures as many managers would thereby exclude a key part of their potential

client base. This is particularly the case as many fund buyers run centralised buy lists across both the discretionary and advisory mandates. If a UCITS is not eligible as it cannot be included in a fund of fund offering it is also likely to be excluded from other distribution channels. To counter this problem we recommend that the 10% rule be amended to allow 'look through' to the underlying master into which the feeder UCITS/CIU invests such that the 10% rule applies to the master fund.

The requirement to appoint local facilities and paying agents

The requirement to appoint local facilities any paying agents dates back to the original UCITS Directive in 1985 and has been carried forward in previous revisions to UCITS and also under AIFMD and the ELTIF Regulation. These requirements developed at a time when cross-border bank transfers in the EEC were slow and expensive and it was difficult to obtain adequate information on a cross-border basis at a time before the internet existed. Furthermore, the rules assume a model of direct UCITS sales whereas in practice the vast majority of UCITS sales are intermediated through a local advisor or execution platform, which is designed to facilitate payments and provide access to all information a retail investor may need. The result is that currently managers put in place facilities agents and paying agency agreements around Europe which are in practice never used.

We recommend that these requirements under the UCITS Directive and ELTIF Regulation should be updated with rules which reflect the widespread use of the internet, the ease with which cross border payments can be made and the reality of contemporary distribution models.

Administrative burden and costs associated with regulatory notifications

The current notification process under the passport process requires the submission of a notification file to each of the host competent authorities where the manager intends to market. This process could be further streamlined via a single notification coordinated by ESMA. A maximum range for regulatory notification fees and tariffs could also assist in reducing excessive costs.

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

IFIA welcomes EIOPA's new work stream on infrastructure investments by insurers towards a more detailed treatment of infrastructure investments within the regulatory framework of Solvency II. There are a number of key recommendations we support and would highlight in relation to the question:

- A wide definition infrastructure which dovetails with global, European and national initiatives
- Recognise that investors need to invest in both infrastructure equity and debt and that capital treatment appropriate to each asset class is needed
- Moody's recently conducted a study on "Default and Recovery rates for Project Finance Bank Loans and Infrastructure Default and Recovery Rates 1993-2014". Moody's historical study shows there is strong evidence that the infrastructure deals are typically not pro-cyclical and have low default correlations to the broad market and other infrastructure investments. Adopting a risk module based on counterparty default risk rather than on ongoing spread

volatility which would reflect the long term investment expectations of insurance company investors.

- Recognise the benefits to investors of holding infrastructure through pooled vehicles such as ELTIFs and other similar AIFs

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

Currently pension provision in the EU is heavily fragmented along national lines which increases costs, limits competition and prevents cross-border activity. We welcome the work of EIOPA to devise solutions to create an EU single market for pensions. In that regard, it should be made easier and at worst tax-neutral to merge/consolidate pension holdings in EU countries into a single individualised scheme.

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

IFIA welcomed the launch of the European Venture Capital Fund (EuVECA) with the aim of boosting investment in SMEs by promoting the development of a cross-border venture capital industry. However, there are currently only 25 EuVECAs established in the EU. A review of the EuVECA structure is therefore required in order to encourage the take-up of this fund product. We have identified a number of actions at the EU level which could facilitate greater investment through EuVECAs. The European Social Entrepreneurship Fund (EuSEF) faces similar challenges and enhancements to the EuVECA should also be considered in respect of the EuSEF.

<u>Relaxing of investment restrictions</u>

The requirement to invest 70% of fund commitments in qualifying investments is considered a deterrent for managers that do not want to take on the risk of guaranteeing that they can find that level qualifying investments. This then dissuades overall investment in SMEs out of a concern over compliance. A restriction of investments to SMEs with employment not exceeding 250 employees can dissuade managers and certain innovative and rapidly growing SMEs can quickly achieve this number. The requirement that secured or unsecured loans not exceed 30% of fund commitments is also viewed as reducing the flexibility of the manager to determine an appropriate balance of debt and equity according the specific circumstances of the project and market conditions.

<u>Minimising the compliance burden</u>

A proportionate regime for EuVECA is critical to its success. The relaxing of the investment compliance restrictions as outlined above could help in that regard. A further step to encourage take-up of EuVECAs among managers deterred by the burden of full compliance with AIFMD could be to exempt AuM managed under the EuVECA from the AuM threshold under Article 3 of AIFMD. This would allow managers to set up EuVECAs without taking the risk of being brought into full scope of AIFMD and also allow successful EuVECAs to grow. We also propose that EuVECA funds should be exempted from the Prospectus Directive requirements where these funds are marketed only to professional and "semi-professional" investors.

Extension of the range of eligible funds

Limiting the EuVECA to venture capital funds that meet a specific set of restrictive criteria decreases take-up. Smaller companies may be backed by different types of funds depending on their development phase and the distinction between investment strategies in the private equity area may not be helpful. We propose that the EuVECA be opened not only to venture capital but also growth/expansion and buy-out funds.

Removal of geographic restrictions on the location of the manager/investments

The global nature of capital markets and the need for CMU to fit within a global framework is recognised in the Green Paper. A key objective of CMU is also to attract global capital into Europe. Europe's private equity and venture capital industry is much smaller scale in comparison with the US. Analysis indicates that there are 1,765 private equity firms in Europe managing assets with over $741 million. This compares with 3,972 firms in the US managing assets of $2.2 trillion, while there are 7,981 PE firms globally managing assets in excess of $3.5 trillion. The EU should not block itself off from this external expertise and investment by restricting EuVECAs only to mangers established in the EU and by restricting investments to those located in the EU or third countries with cooperation arrangements or relevant tax agreements with the EU. It is right that the EuVECA should be a European regulated and domiciled fund but non-EU managers with the necessary expertise and available capital should be able to establish EuVECAs and invest internationally (not just in the EU) according to their sector specific expertise.

Removal of the AuM thresholds

The EuVECA is restricted to Alternative Investment Fund Managers (AIFMs) that manage less than €500 million, so called "registered AIFMs". This restriction was intended to enable typically smaller scale venture capital managers to avail of an EU marketing passport without having to comply in full with the significant requirements of the Alternative Investment Fund Managers Directive (AIFMD). However, this restriction significantly limits the scope of the type of manger that can use the structure and has hindered the growth of the EuVECA. The focus should be on calibrating the EuVECA correctly so that it can serve the purpose of promoting investment in non-listed companies rather than restricting the type of managers that can avail of the structure. By promoting the EuVECA brand as one that can used by AIFMs, no matter what their level of AUM, we would hope that that its brand awareness would increase in PE circles so that it could, in time, become almost as recognisable as the UCITS brand.

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

The private equity industry is largely concentrated in the US, where half of all private equity firms are located and from where 63% of the world's private equity assets are managed (Prequin, 2014). Therefore, the EU should seek to draw on best practice from the US insofar as possible and seek to address barriers to international private equity firms operating in the EU as per our answers under Question 14. We have the following specific comments:

- Our comments in relation to removing regulatory, accounting and tax barriers as per Questions 3 and 10 are equally valid in the context of promoting investment in private equity. Rules relating to capital requirements under Solvency II, CRD or IORP must not deter investment from investment from insurers, pension funds and banks.
- In the absence of the comparably large private equity investor base that exists in the US (e.g. large university endowments) and with an industry that lacks the same scale as in the US, the EU could promote public-private partnerships investing in private equity as a means of building a more scalable private equity and venture capital industry.
- An extension of the scope of the General Block Exemption Regulation (GBER) to the risk finance of start-ups and innovative SMEs under state aid rules could help promote venture capital. The current limits are not considered appropriate for start-up and innovative SMEs.
- Exit opportunities would be enhanced by enhancing IPO markets in Europe – we support the recommendations of the IPO Taskforce, chaired by Philippe de Backer MEP.
- Member States should be encouraged to review their legal, regulatory and tax regimes to facilitate private equity, as several impediments exist in terms of setting up and using the limited partnership structures essential to private equity.

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

As per our answer to Question 5, some barriers that will need to be addressed at a European level to provide a level playing field between bank and non-bank (such as loan origination funds) lenders include:

- Removal of the legislative preference given to banks in bankruptcy proceedings - equal treatment of bank loans and bonds in bankruptcies
- Standardisation of procedures for taking security, enforcement and for creating loans/bonds, in particular equivalent standards for European company registers for registering and enforcing pledges and similar charges
- Remove barriers to lending (as distinct from deposit taking) such as the need for banking licenses etc. by allowing other regulated institutional investors or vehicles to lend
- Additional initiatives to align tax incentives at national level such as: a) the removal of withholding and of transaction taxes on lending/interest, at least within the EU and b) the legislative preference given to banks, for example in taking security (stamp duties etc.) and transaction taxes.

We would suggest that a key focus of the CMU is to look at how to surmount these barriers. Some of our members have suggested the creation of an 'asset passport' that would give qualified funds (certain AIFs or ELTIFs) the right to deploy capital cross-border on an equal footing with banks. This would, in effect, address some of these barriers in a product-specific way, rather than going down the long and politically-challenging path of harmonising all of the relevant legal frameworks across all of Europe.

Boosting retail investment

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

According to an ECB statistics paper (Series No 2 / April 2013) only a small fraction of European households – between 5% and 12% – own bonds, publicly traded shares or mutual funds. The paper goes on to state that the ownership rates of mutual funds follow a broadly similar pattern to that of traded shares, with participation being very much related to income and net wealth, age of the reference person, education and work status.

Among households in the lowest quintile of the income distribution, only 2.2% own publicly traded shares, in contrast to 24.4% in the top quintile. This difference is very similar to the one observed in terms of wealth distribution, where around 1 out of 4 households in the top quintile own publicly traded shares, in contrast with around 1 out of 83 households in the bottom quintile. With regard to age, holdings of publicly traded shares also show a hump shape, initially increasing with age and then declining, a pattern that is in line with a life-cycle behaviour of accumulating savings over working-life, while spending savings after retirement.

The report also suggested that, age and education might jointly explain the hump-shaped holding of shares. Indeed, ownership rates differ substantially by education (only 4.2% of households with a reference person with primary or no completed education participate in stock markets, as opposed to 19.6% of households where the reference person has received tertiary education).

Looking at the market in a different way, according to EFAMA, at the end of 2013, financial assets of households (retail investors) in Europe were allocated 41.6% to deposits, 37.4% to insurance and pension savings, 8.5% to investment funds, 7.3% to debt securities and 5.2% to quoted shares.

In contrast, in the US, according to the US Investment Company Institute (ICI), the greatest share of registered investment company assets is held by households, and registered investment companies managed 22% of household financial assets at year-end 2013. Approximately 43% of US households own mutual funds.

With this background in mind it is worth looking at how investing behaviours might be influenced to boost retail investor participation in the capital markets.

<u>Financial education</u>

It is clear that educational attainment is an important factor which influences investing behaviour. Planning for retirement has never been more important but is often something which is left until later in life. The concepts and basic principles of saving and investing should be included in the primary/junior school curriculum.

<u>Measures to encourage long-term savings</u>

In the US 401(k) employer-sponsored retirement plans have become a common channel through which households own mutual funds and this has contributed to the high proportion of US households owning

such funds. European households also contribute to the institutional client segment through their ownership of unit-linked products offered by insurance companies and pension schemes. More measures to encourage personal pension provision such as tax incentives and awareness campaigns should be implemented. Collective investment funds such as UCITS funds have many of the features that could be used for such pension saving schemes.

Enabling greater comparisons of products under distribution channels

Banks and insurance companies control a very significant proportion of the distribution channels for all financial products in Europe. As a result retail investors are presented with a range of different and competing products and making an informed comparison between these differing products can be challenging and confusing. The UCITS KIID has gone some way to achieving this by enabling comparison between different UCITS funds and the introduction of a common standardised approach to retail disclosures under the PRIIPs KID initiative is needed to enable cross product comparisons on a consistent basis.

Treatment of commissions

How investment funds are distributed and the current MIFID II proposals which ban commissions for IFAs only while bank-dominated distribution channels are not directly affected could distort the environment and impact on the distribution of investment funds to retail investors.

Increasing efficiencies

Positive steps were taken under UCITS IV to help consolidate fund products and consequently to reduce operating costs of investment funds. Further enhancements should be implemented such as:

- Eliminating goldplating of EU regulations by national regulators when UCITS fund are being passported from one member state to another
- Standardising the definition of marketing across all member states and implement consistent rules on advertising
- Removing the requirement for UCITS funds which are listed on EU regulations markets and therefore classified as Public Interest Entities, to comply with the same regulatory and disclosure requirements which PIE's such as banks and multinational corporate entities are required to comply with

Enhancing advice for savers

While UCITS is an undoubted success, there are still many opportunities for a wider section of European citizens to use UCITS as their principal savings vehicle. There needs to be a further assessment of barriers, both behavioural and regulatory which discourage greater take up of UCITS so that policy makers and industry can work together to increase the take up of UCITS. In particular there needs to be a reassessment of the current framework for advice and guidance to ensure it meets savers' needs. A key priority is to define minimum standards for guidance and use technology, to make savings accessible to wider segments of European citizens. This can be delivered by agreeing a minimum standard of entry-level financial guidance to assist uncertain savers who do not know where to begin. This could achieved by putting in place common standards agreed between industry, consumer bodies and regulators to give consistent guidance to savers who want to put a savings plan in place.

Marketing and distribution – open architecture

Retail distribution in many Member States remains dominated by the local banks, which can inhibit the distribution of cross-border retail funds. The Commission should encourage the further development of "open architecture" fund platforms that enable investors and advisors to buy from a wide range of providers in one place. Greater digitalisation of fund distribution via online platforms should facilitate this. However, marketing restrictions and requirements can frustrate the use of technology and online platforms to reach retail investors. Therefore we encourage a review of the current framework for marketing, advice and guidance in order to boost cross-border retail investment. In particular, we suggest that this includes a review of how investor protection rules in national regulation could be applied more efficiently and on a more standardised basis and so reduce barrier to entry to cross-borders providers. Greater consistency of rules in this area will encourage a cross-border approach to investment

Impact of the EU Financial Transactions Tax

The potential impact which the proposed European Union Financial Transaction Tax (EU FTT) could have on the distribution of investment funds should be reviewed. If the purchase and sale of units or shares in investments funds is subject to FTT this will increase the costs to all investors of investing in UCITS funds and also adversely impact on the return which such investors derive from their investments.

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

The ESAs have an important role to play in ensuring the EU legislation is effectively implemented and enforced and in promoting supervisory convergence. Too often Member States either gold-plate or delay implementation of EU rules which undermines the Single Market. We therefore generally welcome supervisory convergence as a means to ensuring consistent consumer and investor protection and limiting the scope for regulatory arbitrage. Increased focus on the requirement for consistency on the introduction and the application of new regulations in each Member State is a welcome development and needs to be kept to the fore as further and new regulations are introduced on an ongoing basis. Otherwise, the outcome is a patchwork of local rules which undermine a cross-border approach.

There could be scope for the ESAs to contribute to improving financial literacy and the creation of standardised and simple information on financial products across the EU. We would highlight the role of the KID in that regard. In addition, measures such as those outlined in Question 17 above regarding the simplification of offering documents for all investment products would be welcome, particularly any further or additional steps around the use of clear and simple language in the disclosure of performance related information. We also foresee a role for the ESAs in promoting greater consistency of marketing rules with a view to ensuring consistent and appropriate investor protection rules across Member States and enhance cross-border retail investment.

The introduction of the new whistle blowing provisions under UCITS V is another welcome development and the operation of that mechanism in practice should go a long way to increasing investor confidence, particularly in the retail sector. Further developments in this area would include the introduction of simpler methods or a mechanism making it easier for investors to enforce their rights cross border.

The introduction of the UCITS V provisions facilitating greater co-operation between regulators is welcome. This will hopefully lead to better alignment between regulators in the imposition of sanctions which are already on the books but need to be applied and be seen to be applied so that investors can take more comfort and be more confident in investing in a broader range of investment products cross border. It is only with the expansion and development of the cross border support structure, beginning with the Regulators but filtering down to all participants in the cross border financial services industry, that retail investors will gain a better understanding of the rules and the increased confidence required to encourage them to broaden their investment horizons in terms of both the range of investment products and domicile of same.

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

Investor demand will continue to grow in the long term. The demographic drivers which are already at play such as aging population and the gradual reduction in state pension coverage will increase demand for long-term savings and investments.

Unlocking household savings requires investors to have the knowledge, confidence and support necessary to understand the risks and benefits of different options so they can make informed investment decisions. It also requires a transparent market which supplies well regulated products and services which retail investors want, need and understand.

The UCITS product is already the key product in cross border retail participation in Europe and measures which seek to boost retail investment should be centred around the already successful UCITS product.

To be able to make informed decisions, investors need the basis for a meaningful comparison of risks and costs, within and across product types in language and terms that they can understand. This means that disclosure requirements must be fit for purpose and designed to help investors make the right decisions. Europe has already made significant progress in this area with PRIIPs and MiFID. In order for these reforms to be effective, it will be crucial to ensure requirements under UCITS, PRIIPs and MIFID II are consistent.

In addition to our responses provided under Question 17, policy measures that could promote retail investment include:

- Increasing the focus on saving and investing as part of the early school curriculum ensuring that all children of school going age receive a basic understanding of the concepts of saving and investing.
- Making it easier for employers to provide portal retire saving plans as part of the remuneration package available to employees.
- Creating a pan-European personal pension fund which is easily transferable between employers (including on a cross border basis).
- Measures to encourage governments to increase savings should also be considered (such as the Special Savings Incentive Account in Ireland) where Governments would incentivise citizens to open investment accounts and contribute a certain amount each month for a set period of time.

- Banks and insurance companies control a very significant proportion of the distribution channels for all financial products in Europe. As a result retail investors are presented with a range of different and competing products and making an informed comparison between these differing products can be challenging and confusing. The UCITS KIID has gone some way to achieving this by enabling comparison between different UCITS funds and the introduction of a common standardised approach to retail disclosures under the PRIIPs KID initiative is needed to enable cross product comparisons on a consistent basis.
- How investment funds are distributed and the current MIFID II proposals which ban commissions for IFAs only while bank-dominated distribution channels are not directly affected could distort the environment and impact on the distribution of investment funds to retail investors. A level playing field needs to be created.

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

The UCITS product is already the key product in cross border retail participation in Europe and measures which seek to boost retail investment should be centred enhancing and protecting this product.

Attracting international investment

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

We would reiterate the importance of our comments in response to Question 1 in relation to the avoidance of unnecessary regulatory and administrative burdens, ensuring a level playing field and consistency between EU policies and with global regulatory frameworks. In that regard, we would emphasise the importance of international regulatory cooperation through IOSCO and the need for greater convergence via common standards and principles. We would also highlight our concerns over the potential impact of an EU-wide Financial Transactions Tax in terms of increasing the costs of doing business in the Europe and deterring international investment (see our response to Q. 30).

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

The EU is contemplating opening up its markets to third countries via passports under AIFMD and MiFID but significant barriers to accessing non-EU markets remain in place. We would encourage the European Commission to include the distribution of EU cross-border funds and the removal of distribution barriers to EU funds on its international trade policy agenda. In order to ensure investor protection is not undermined and in order to avoid market distortions, any access by third country firms to EU markets needs to be based on an appropriate level of regulatory standards and oversight in the third country.

We would also encourage ESMA to support dialogue and increase interaction with regulatory authorities in third countries with a view to facilitating the distribution of EU funds into third countries. ESMA has

more recently taken on the role of negotiating MoUs with third countries and this activity could be extended to enhance international distribution possibilities for EU investment funds.

Improving the investment chain – intermediaries, infrastructures and the broader legal Framework

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

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

We note that the CMU proposals are intended to be introduced within a "single rulebook". We agree with the concept of a single rulebook and consider it beneficial to have a harmonised approach to the implementation of financial legislation when it is enforced effectively and consistently. However, we would caution against turning CMU into an exercise which leads to gold-plating arising as a result of the drive to ensure harmonisation. Striking the right balance in terms of any regulation arising out of CMU will be critical. Any review of financial services legislation should include an evaluation of the appropriateness and effectiveness of the legislation, including whether it is achieving its goal in a proportionate manner. Regulatory initiatives envisaged under CMU should undergo a thorough economic impact assessment and a thorough check for consistency with each other.

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

We generally welcome supervisory convergence through the single rulebook and guidance upon its interpretation (in respect of operational requirements and investment restrictions), as this will help to bring about a level playing field with less scope for regulatory arbitrage. One specific area which we would suggest is considered is that of reporting. Each and every national regulator has to develop its own reporting platform/system all of which are different and vary in terms of sophistication. We suggest a Common European Reporting Platform controlled by ESMA to which all stakeholders submit their data and from which all regulators can obtain the information necessary for supervision. A central point of data collection/reporting would ensure consistency and quality of information is controlled.

We would draw a distinction between consistent application of the single rulebook through supervisory convergence and peer review versus a pan-European supervisor (as has occurred under Banking Union). We do not think that a pan-European supervisor is necessary or desirable and could serve to detract from the key goal of establishing CMU by 2019.

In relation to supervisory convergence it may be worth reviewing the effectiveness of the comply or explain procedures in respect the adoption of ESMA Guidelines by EU Member State regulators to ensure consistent application of the proposed standards in all Member States.

While considerable work has been done in recent years in relation for example to cross border mergers, we agree that considerably more work could be done in areas such as insolvency.

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

Traditionally there is much less incidence of retail investment in securities (in particular debt securities) in Europe compared to for example the US. This is as much a cultural historical issue as due to any other factor. However any initiative that can be undertaken to encourage a retail market in securities would be beneficial to the market as a whole.

In addition, the much more detailed disclosure requirements for retail debt transactions make their establishment very costly and prohibitive. Consideration should be given as to whether the extra restrictions required provide any additional protections to investors considering the cost.

Recent high capital charges for banks holding debt securities and a general regulatory bias against banks' trading activities have resulted in a significant loss of liquidity in the bond markets. In the future, in particular in a higher interest rate environment, this lack of market-making activity in the bond markets may significantly hinder the development of the market. Consideration should be given to whether the restrictions imposed on banks making a market in bonds is beneficial.

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

As acknowledged by the Commission in Question 27, the cross-border flow of collateral is and will continue to be vital to well-functioning capital markets, both in Europe and globally. The significance of and demand for freely transferable collateral will only increase with the implementation of new EU and global rules that mandate or encourage the use of collateral as a risk mitigation tool.

In this environment, the introduction of reforms designed to minimise local law discrepancies and reduce risk associated with cross-border enforceability of collateral could in principle be highly valuable for EU markets. It is critical, however, that any new measures or requirements introduced in this area are developed with appropriate regard for the complexity of existing laws and the importance of current market practice in establishing and maintaining vital legal and operational certainty for participants. If reforms are introduced without due consideration for existing law and practice at local and international level, there is a risk that new rules that are designed to enhance legal and operational certainty could risk creating the opposite effect. There have been a number of examples where specific rules on collateral have not been considered in light of existing international market practices e.g. ESMA Guidelines on ETFs and other UCITS issues; UCITS V Directive 2014/91/EU Article 1 (4) (Article 22 (7)); and segregation requirements under AIFMD which are now subject to ESMA consultation. Such rules can have a significant impact on cross- border flow of collateral.

However, providing greater clarity on the disposition of securities equivalent to the framework for the collateralisation of derivatives under the Financial Collateral Directive (FCD) would be beneficial for capital markets integration in Europe. Cross-border holdings require chains of ownership, with

potential for different laws (insolvency and contractual) to apply to each relationship in the chain and to each type of intermediary. This could be addressed through an extension to the FCD.

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

The main obstacles to integrated capital markets arising from company law, including corporate governance is the lack of harmonisation and lack of transparency in this area. Investors are likely to be significantly deterred from investing on a cross-border basis if they are uncertain as to the applicable company law provisions and the regulatory framework in which those provisions operate. Clearly, harmonising company law throughout the EU would contribute significantly to investor confidence in this regard. A consistent approach to cross-border voting rights would be helpful in this regard.

In the absence of such harmonisation, increased transparency would go some way to promoting investor confidence in investing in SMEs. For example, the EU/Member States could consider establishing a website for SME investors with Q&A covering the typical concerns of investors and providing information as to where to obtain other reliable information on a cost-effective basis. Increased transparency over SME information would also help counter credit risk which may well be the key obstacle to increased SME lending.

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

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

<u>BEPS</u>

The OECD Action Plan on Base Erosion and Profit Shifting (BEPS), published in July 2013, identified 15 actions to address BEPS in a comprehensive manner. One of these areas for action is to "prevent the granting of treaty benefits in inappropriate circumstances" (Action 6). Action 6 proposed the introduction of two possible tests which would need to be met in order to obtain treaty benefits – the Principal Purpose Test (PPT) and the Limitation on Benefits Test (LOB).

The OECD was mandated under Action 6 to conduct further work with respect to treaty entitlement of collective investment vehicles (CIVs) and non-CIV funds. To take this forward, the OECD published on 21 November 2014 a discussion draft for public comment.

The introduction of either the PPT or LOB rule as currently drafted would represent a significant threat to the cross-border funds industry, as both would likely favour domestic funds comprising of local investors.

A CIV is very unlikely to be established or used for treaty abuse purposes. For this reason and recognising that the purpose of Action 6 of the BEPS project is to prevent treaty abuse, it is our view

that, to the greatest extent possible, the output from Action 6 should impose no additional impediments on CIVs ability to obtain treaty reliefs.

In this regard, we support the conclusions of the OECD's 2010 CIV Report, which recognises the importance of widely held funds being able to access treaty benefits. This report should continue to be the basis for determining treaty access for CIVs, particularly with regard to CMU's objective of promoting cross-border funds. As a result, we would strongly recommend that CIVs should be expressly exempted from any possible application of both the LOB and PPT rules as a result of BEPS Action 6.

We note that the 2010 CIV Report did not deal with treaty entitlement issues relating to collective investment funds which are not widely held, regulated and diversified. This may include some classes of private equity funds and alternative funds which share many of the same characteristics as CIVs. In particular, (like CIVs) non-CIV funds are established for bona fide commercial purposes.

As such, it is equally important that the output from Action 6 imposes no additional impediments on bona fide commercial non-CIV funds ability to obtain treaty benefits. We would recommend that work similar to the 2010 CIV Report needs to be undertaken through the OECD Informal Consultative Group to identify issues across the various types of non-CIV funds and develop practical solutions for treaty entitlement.

From a general EU and CMU perspective, it is also critically important to ensure that any LOB rule does not impact on the free movement of capital and establishment within the EU. As currently drafted, the LOB rule could restrict treaty access to entities owned predominately by local residents, which conflicts with the fundamental free movement principles of the EU. In order to ensure that the LOB clause does not work in an unduly restrictive manner, we would recommend either 1) a complete exemption from the LOB clause for capital flows between residents of EU Member States or, alternatively 2) the introduction of an appropriately worded "Derivative Benefits" test which takes account of EU law and freedoms. This is necessary to ensure that any LOB rule does not unduly restrict the entitlement of EU residents to access treaty benefits in respect of transactions with residents of other EU Member States.

Withholding Taxes

Withholding taxes on interest and dividend payments from residents of one Member State to another are the most fundamental pre-existing tax issue for capital markets in the EU. While there are a number of local domestic exemptions from withholding taxes in various EU Member States, EU action on eliminating withholding tax has, to date, been largely restricted to intra-group payments.

CIVs in particular often suffer withholding taxes on the receipt of interest and dividends from other EU Member States which either 1) represents a real cost to the CIV or 2) requires an often lengthy refund application process via the tax authority in the relevant Member State.

The Green Paper makes a number of references to the huge scale of capital markets funding in the U.S. relative to the EU, and acknowledges that the CMU proposals need to help close this funding gap. In this regard, it is worth noting that the U.S. does not have any withholding tax on the payment of inter-state interest and dividends. From a taxation perspective, this is one of the key differences which currently exist between the U.S. capital markets and EU capital markets.

In light of the above, the abolition of withholding tax on interest and dividend payments between EU Member State residents needs to be actively considered as part of the CMU project. Abolition of such withholding taxes would remove one of the main barriers to cross-border investment within the EU and help the move toward a single market for capital across all EU Member States.

FTT

The introduction of an FTT which taxes instruments and intermediaries (e.g. investment funds) critical to CMU has the potential to create a significant barrier to the success of CMU.

For example, if the purchase and sale of units or shares in investments funds is subject to FTT this could increase the costs to investors of investing in investment funds and also adversely impact on the return which investors derive from their investment.

We welcome the ongoing opposition to the introduction of an FTT by the non-participating Member States. We would recommend that, as part of the implementation of any CMU proposals, strong consideration is given to the abolition of the FTT across all EU Member States.

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

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

It is important that Capital Markets Union does not just look at existing issues but also looks forward to the future and the potential for capital flows to be changed by the development of financial technology. It is therefore important that any future policy measures are future proofed so that they are flexible enough to take into account financial innovation and the increased digitalisation of capital markets.